Alberta Legislature

Annual Report of the Auditor General 1985-86

Alberta Legislature

Office of the Auditor General

Mr. G. Stevens, P. Eng., M.L.A.
Chairman
Select Standing Committee
on Legislative Offices

I have the honour to transmit herewith my Report to the Legislative Assembly for the fiscal year ended March 31, 1986, to be laid before the Legislative Assembly in accordance with the requirements of section 19(4) of the Auditor General Act.

Donald D. Salmon

C.A.
Auditor General

Edmonton, Alberta
January 12, 1987

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REPORT OF THE AUDITOR GENERAL OF ALBERTA

FOR THE YEAR ENDED

MARCH 31, 1986

SECTION 1

1.1 INTRODUCTION AND OVERALL ASSESSMENT

1.1.1 This report is issued pursuant to section 19 of the Auditor General Act. Although this is my first annual report, it is the eighth annual report of the Auditor General to the Legislative Assembly of Alberta. The seven previous reports were those of my predecessor D.W. (Bill) Rogers, F.C.A. who retired on March 31, 1986.

Section 2 of the report outlines the audit activities undertaken for each government department and agency, and describes the audit findings, conclusions and recommendations which, in my opinion, are significant enough to warrant the attention of the Legislative Assembly.

Section 3 of the report explains the types of audit activities undertaken and the criteria that I use to decide which audit observations and recommendations to report to the Legislative Assembly. It also contains a summary of the audit report reservations issued for 1985-86, and a brief commentary on the Province's operating results. Section 4 describes the responsibilities, audit approaches and organization of my Office.

Although this report is for the year ended March 31, 1986, some observations and recommendations have arisen from audit work undertaken since that date. This is because much of the audit work that enabled me to report on the Province's financial administration and accountability during 1985-86 was performed during 1986-87.

Section 19 of the Auditor General Act prescribes the nature of the matters that I must include in this report, as well as those matters where discretion is allowed. Many of these are shortcomings and irregularities such as systems weaknesses, control deficiencies, non-compliance with legislation, and unsatisfactory accounting and reporting practices. This report, therefore, must be viewed as a "report by exception" and cannot form the basis for a balanced evaluation of the Province's financial administration.

Overall Assessment

1.1.2 Section 2 of this report shows that relatively few of the over two hundred audits and special reviews conducted by my Office for the 1985-86 fiscal year resulted in findings or recommendations significant enough, in my opinion, to be brought to the attention of the Legislative Assembly. This speaks well for the general quality of the Province's financial administration. Based on the work of my Office, I consider that the financial affairs of the Province were administered in a generally satisfactory manner during the 1985-86 fiscal year of the Crown. There is, however, scope for improvement as evidenced by the audit findings, conclusions and recommendations contained in this report.

Acknowledgements

1.1.3 My responsibilities and those of my staff can always be discharged more effectively with the ready co-operation of those whose affairs we audit. For this reason, I am pleased to acknowledge with gratitude the excellent co-operation extended to my staff by management and staff of departments and agencies.

Furthermore, pursuant to section 19(1)(b) of the Auditor General Act, I am pleased to report that in carrying out the work of my Office, my staff received all the information, reports and explanations that they required.

Donald D. Salmon

C.A.
Auditor General

Edmonton, Alberta
January 12, 1987

SECTION 2

2 AUDIT FINDINGS, OBSERVATIONS AND RECOMMENDATIONS

2.1 INTRODUCTION

2.1.1 This section of the report outlines the 1985-86 audit activities undertaken for each Provincial department, agency and fund. The audit observations and recommendations reported herein are those which the Auditor General considers should be brought to the attention of the Legislative Assembly.

The types of audit activity undertaken, and the criteria used when deciding which observations and recommendations should be reported herein, are explained in section 3.1.

2.1.2 At the back of this report is a complete index of all entities of which the Auditor General is auditor. It can be used by readers to find references to individual entities in this report, and in the public accounts.

The Auditor General has made recommendations in this report relating to the following:

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2.2 CONSOLIDATED FINANCIAL STATEMENTS OF THE PROVINCE

2.2.1 The Consolidated Financial Statements of the Province for the 1985-86 fiscal year of the Crown are published in section 1 of volume 1 of the 1985-86 public accounts. The notes to the consolidated statements explain the accounting policies and reporting practices employed in preparing them. A commentary on the consolidation methods is included in section 3.4 of this report, together with selected consolidated operating statistics.

The Auditor General reported without reservation on the consolidated statements of the year ended March 31, 1986. His report is reproduced in section 3.3 of this report.

The majority of the figures that go to make up the consolidated statements were audited while examining the operations and financial statements of the various departments, funds and agencies that are consolidated. The observations and recommendations below arose from the audit of the consolidation process and the form of the consolidated statements.

Observations from Financial Audit Work

Agencies not consolidated — The consolidated financial statements of the Province would provide a more comprehensive overview of the Province's overall financial position if they included the Provincially-owned universities, colleges, technical institutes and hospitals.

The title "Consolidated Financial Statements of the Province of Alberta" may lead readers to assume that the statements combine the financial positions of virtually all entities owned by the Province. In the case of Alberta's consolidated statements, however, this would be an incorrect assumption. Alberta's consolidated statements do not include the Provincially-owned universities, colleges, technical institutes and hospitals. If the recorded net assets (excluding fixed assets) of these entities were included in the consolidation, the Province's accumulated surplus at March 31, 1986 would be increased by approximately $43 million.

The reason for this exclusion is explained in the introduction to the consolidated statements in the public accounts, as: "The following corporations are excluded from the definition of Provincial corporation and are exempted from all other provisions of the Financial Administration Act except section 2, which provides the exemption, and section 81 respecting the approval of borrowing by the Provincial Treasurer. Accordingly their accounts are excluded from the Public Accounts and the consolidated financial statements." Thereafter are listed the statutes under which the Province's universities, colleges, technical institutes and hospitals operate.

The above-quoted explanation implies that section 2 of the Financial Administration Act requires the financial statements of these entities to be excluded from the consolidated financial statements and the public accounts. This, however, is not the case. A legal opinion obtained by the Auditor General on the effects of sections 2 and 77 of the Financial Administration Act states that there are no legislative constraints to including the financial statements of these entities in the consolidated statements (or in the public accounts), and that the Provincial Treasurer may do so if he wishes. Treasury Department officials acknowledge that the Provincial Treasurer may include them if he considers their inclusion appropriate but present policy is to exclude them in view of the limited financial control over these agencies that the Government exercises.

Further support for the concept that consolidated statements should include all government-owned entities is to be found in Public Sector Accounting Statement 2 issued by the Public Sector Accounting and Auditing Committee of the Canadian Institute of Chartered Accountants. This Statement deals with the objectives of government financial statements and states:

> ".27 Since all government entities derive powers from legislation and since legislation authorizes the use of public financial resources, the legislature has the right and responsibility to obtain an adequate accounting of their financial affairs. Financial statements for

individual government entities are now provided to legislatures to account for their operations. These statements disclose detailed information about the financial activities of the entities and constitute important accountability reports by their respective managements. However, these statements do not provide legislators, investors and other groups with an understandable overview of the full range of financial activities for which the government is responsible. Only the government is able to provide the legislature with this financial overview.

.28 To account for the full nature and extent of the affairs for which the government has a responsibility, financial statements should include information to account for not only the entity represented by the general (or consolidated) fund, but also the funds, agencies and enterprises which do not form part of the general fund. Thus the summary financial statements of a government should evidence the government's accountability in this broad sense."

In the management letter to the Deputy Provincial Treasurer, Management and Control at the conclusion of the audit, the Auditor General noted that there appears to be no restriction to including in the consolidated financial statements those entities presently excluded. Accordingly, he suggested that the Treasury Department reconsider the present practice and made the following recommendation:

Recommendation No. 1

It is recommended that, in future, the Provincial Treasurer consider including the Provincially-owned universities, colleges, technical institutes and hospitals in the consolidated financial statements of the Province, perhaps on an equity accounting basis.

Follow-up of Previous Annual Report Recommendations

Pension liabilities — In previous annual reports, the Auditor General recommended that consideration be given to reflecting the obligations arising under the various pension plans administered and/or guaranteed by the Province as a liability in the Province's financial statements. He also recommended that interim valuations of the Province's pension obligations be prepared by independent actuaries at fiscal year-ends when full actuarial valuations are not prepared. Further, that the Treasury Department and the Board of Administrators of the Teachers' Retirement Fund employ common economic assumptions when valuing the pension plans administered by the Province of Alberta and the Teachers' Retirement Fund.

At present, the consolidated balance sheet records as a liability (restricted profits and equity) only the portion of the Province's actuarially valued pension obligations that is covered by assets set aside for that purpose. The very considerable portion of those obligations for which assets have not been set aside is disclosed only in a footnote to the consolidated financial statements.

These pension obligations arise from seven plans administered or guaranteed by the Province. Six of the plans operate pursuant to the Local Authorities Pension Plan Act, the Members of the Legislative Assembly Pension Plan Act, the Public Service Management Pension Plan Act, the Public Service Pension Plan Act, the Special Forces Pension Plan Act, and the Universities Academic Pension Plan Act. The seventh plan, the liabilities of which have been guaranteed by the Province, operates pursuant to the Teachers' Retirement Fund Act.

Actuarial valuations for the six plans were last obtained as at March 1985, and for the seventh plan as at August, 1983.

The following summary shows the pension obligations, pension fund assets and unrecorded liability as at March 31, 1985. The amount of the unfunded liability at March 31, 1985 for the Teachers' Retirement Fund was estimated by the actuaries when preparing the Fund's 1983 valuation.

	Valuations as at March 31, 1985 (Millions of Dollars)
Local Authorities Pension Plan Act	$2,684
Members of the Legislative Assembly Pension Plan Act	30
Public Service Management Pension Plan Act	905
Public Service Pension Plan Act	1,654
Special Forces Pension Plan Act	389
Universities Academic Pension Plan Act	781
	6,443
Deduct: Pension Fund assets	2,564
	3,879
Teachers' Retirement Fund Act (unfunded portion)	1,480
Unrecorded liability	$5,359

The above amounts are recorded in a footnote to the March 31, 1986 consolidated financial statements. The footnote also indicates that the consulting actuary who prepared the 1983 valuation for the Teachers' Retirement Fund estimated at that time that the unfunded accrued liability would amount to approximately $1.62 billion at March 31, 1986.

If the unrecorded liability of approximately $5.36 billion at March 31, 1985 remained unchanged at March 31, 1986, and was recorded as a liability in the consolidated financial statements, the consolidated surplus at March 31, 1986 would be reduced from $12.60 billion to $7.24 billion.

In his response to the Auditor General's 1984-85 recommendation that the Province's pension obligations be recorded as a liability, the Provincial Treasurer stated that the financial statement disclosure of unfunded pension obligations recommended by the Auditor General is not the general practice of governments in Canada. He also stated that the Government considers that its current practice of disclosing the pension liability by way of a footnote to the financial statements is appropriate. He noted that the Public Sector Accounting and Auditing Committee (PSAAC) of the Canadian Institute of Chartered Accountants (CICA) has identified accounting for pension costs as an area for future research, and that the present practice will continue to be reviewed as generally accepted accounting policies evolve in this area.

In April 1986, the CICA issued accounting recommendations for pension costs and obligations. These require profit-oriented entities that have established a pension plan to reflect in their financial statements all pension benefit costs accruing to employees, not just the amounts paid to fund the plan. Governments are not required to base their accounting policies on the CICA Handbook, nevertheless, these new recommendations are indicative of the general direction in which the reporting of pension obligations appears to be developing.

It is acknowledged that the disclosure of pension obligations as recommended by the Auditor General is not common practice among Governments in Canada, and that PSAAC has not issued recommendations in this area. However, the Auditor General still believes that the financial position of the Province would be presented more meaningfully if the total liability for pension obligations was reflected as a liability in the financial statements of the Province. Given the magnitude of the unrecorded liability and the trend developing with respect to the reporting of pension obligations, the Auditor General believes strongly that the Government should reconsider its position on this matter.

In response to the Auditor General's 1984-85 recommendations regarding actuarial valuations, the Provincial Treasurer stated that the need for obtaining interim valuations before the next full actuarial valuations are obtained will be reviewed. He also stated that the Treasury Department will continue discussions with the Board of Administrators of the Teachers' Retirement Fund in

an attempt to have common economic assumptions employed when valuing the Province's pension plans.

It was subsequently decided, however, that due to budgetary constraints, interim valuations would not be obtained for 1986. This raises concerns because previous actuarial valuations have disclosed continued significant growth in the Province's unfunded pension obligations. Further, the 1985 actuarial valuations revealed that contributions for the six plans will likely be lower than their estimated normal costs and, therefore, it is probable that the Province's unfunded pension obligations will continue to grow. Lack of timely and accurate information about the Province's pension obligations could hinder the Government's ability to deal effectively with the growth in the Province's unfunded pension liability.

Although the economic assumptions used when valuing the Teachers' Retirement Fund Plan differ from the assumptions used when valuing the other six plans, progress has been made over the years towards a common actuarial valuation basis for all of the plans. For this reason, and because the Provincial Treasurer has undertaken to continue to pursue this matter with the Board of Administrators of the Teachers' Retirement Fund, the Auditor General did not repeat the aforementioned recommendations at the conclusion of the 1985-86 audit. Future audits, however, will include reviews of the valuation bases used and the compatibility thereof.

In the management letter to the Deputy Provincial Treasurer, Management and Control at the conclusion of the 1985-86 audit, the Auditor General made the following recommendation:

Recommendation No. 2

It is recommended that the Provincial Treasurer reconsider:

— *reflecting the unrecorded liability arising from the various pension plans administered and/or guaranteed by the Province as a liability in the financial statements of the Province, and*

— *obtaining interim valuations of the Province's pension obligations from independent actuaries at fiscal year-ends when full actuarial valuations are not prepared. Such action should also extend to the Teachers' Retirement Fund Pension Plan.*

Timeliness of financial reporting — In his last four annual reports, the Auditor General has suggested that the Province's annual public accounts would be more meaningful and useful if they were released earlier.

It is generally acknowledged that for reports to be useful, they must be timely. If the reported information is old or out of date, its potential value diminishes accordingly. Yet in recent years, the Province's public accounts have been released approximately one year after the end of the fiscal years to which they related.

In his previous annual reports, the Auditor General recommended that efforts be made to release the Province's public accounts during the fall session of the Legislature. That is, four or five months earlier than at present.

It is acknowledged that the current environment of fiscal restraint is hardly conducive to spending scarce resources on new or modified accounting systems that would, in some cases, be needed to produce more timely public reporting. Nevertheless, the advantages to be derived from earlier reporting can be significant. In times of economic uncertainty, the Government would be better able to determine and act upon income and other resource changes, as well as to demonstrate the basis for its actions and decisions. Furthermore, the Legislative Assembly and the Public Accounts Committee could review public spending more promptly when the underlying events are more current.

In response to the Auditor General's recommendations in prior years that efforts be made to release the public accounts more promptly, the Provincial Treasurer stated that the Government agrees that timely financial reporting is important. He indicated that efforts will be made to pursue more timely financial reporting by improving communication between the Offices of the Auditor General and the Controller and managements of the various departments and Provincial agencies, aimed at the early detection of problems.

It is gratifying to note that for 1985-86, the Province's public accounts were released more than two months earlier than they have been in recent years.

2.3 LEGISLATIVE ASSEMBLY

2.3.1 This Department comprises the Legislative Assembly Office, the Office of the Chief Electoral Officer, the Ombudsman's Office and the Office of the Auditor General.

The financial statement of the Office of the Auditor General for the year ended March 31, 1986 was audited by a firm of Chartered Accountants and is reproduced on page 28.19 of volume II of the public accounts.

2.3.2 Of the matters reported to management at the conclusion of the audits of the Department's various Offices, none warrant inclusion in this report.

2.4 ADVANCED EDUCATION

Of the matters reported to management, the observations and recommendations below are those which the Auditor General considers should be brought to the attention of the Legislative Assembly.

2.4.1 **Department of Advanced Education** — year ended March 31, 1986

The annual financial audit was extended to include the following:

— An examination of the existence and adequacy of the systems used by the Department to control the co-ordination of programs offered by higher education institutions, and the allocation of grants to such institutions.

— An examination of the existence and adequacy of the system of internal control over the operations of the Alberta Vocational Centre, Grouard.

Observations from Extended Audit Work

The Department pays regular operating grants to higher education institutions to cover ongoing operating costs and the costs of new programs. The system used by the Department for determining funding for new programs is adequate. However, the system used for determining the appropriateness of funding for ongoing operating costs could be improved.

The Department establishes the base operating grant to be paid to an institution by adjusting the previous year's grant for changes resulting from such matters as enrollment and inflation. Additionally, new programs previously funded on a conditional basis which have been approved by the Department are added to the base operating grant. In other words, rather than establishing the base operating grant to be paid to an institution on the basis of the programs and services to be offered, the grant is established primarily by reference to the previous grant paid to the institution.

By instituting a process whereby grants budgeted and paid to an institution are related directly to the cost of the programs and services provided, the Department would strengthen its financial control systems. Among the benefits that could accrue from such a change in the budgeting system are that:

— the Department would be able to assemble Province-wide statistics on the cost of the various programs funded, and additionally would be able to compare the costs of similar programs of study offered by various institutions,

— the Department would have a basis to assess periodically whether grants paid are used for the purposes specified in the grant applications,

— the Department would be assisted in achieving and demonstrating equity in its funding of various institutions,

— the Department would be assisted in the identification of efficiencies achieved by various institutions, and

— the Department would be assisted in achieving its stated objective of coordinating the programs of study offered by higher education institutions.

It is recognized that to implement this change in the budgeting process would require the coordination of the budgeting systems employed by higher education institutions. There would also have to be agreement between the Department and the various higher education institu-

tions on the level of information required to achieve the additional benefits. Consequently, if the recommendation is adopted, it would take time to implement.

Recommendation No. 3

It is recommended that the Department of Advanced Education consider requesting higher education institutions to submit grant applications appropriately analysed to show the cost of the programs and services that the grants will fund.

Observations Arising from the Audits of the Public Colleges

Financial reserves established by higher education institutions (technical institutes and colleges) — The past few years have seen a dramatic increase in the amount of money set aside in financial reserves by the Provincially-owned higher education institutions. At June 1986, these reserves totalled in aggregate approximately $17.6 million, an increase of $4.5 million over the total at June 1985. This money came mainly from unused annual operating grants and is available to be used at the discretion of the boards of the various institutions.

The statutes under which these higher education institutions operate allow them to utilize financial reserves, but are not specific as to how transfers to them and expenditures from these reserves should be approved and controlled. In the view of the Auditor General, the Minister should concur with the establishment and utilization of financial reserves set up by higher education institutions.

Recommendation No. 4

It is recommended that the Department of Advanced Education establish procedures for acquiring the information needed to facilitate the concurrence of the Minister to the establishment and utilization of financial reserves by higher education institutions.

Accounting and reporting by higher education institutions — Sections 2.4.11 to 2.4.23 of this report contain individual observations and recommendations that arose from the audits of the colleges and technical institutes, and which the Auditor General considers should be brought to the attention of the Legislative Assembly. However, the management letters to these higher education institutions contained numerous other observations and recommendations which, although individually not important enough to report separately herein, collectively are cause for concern.

These educational institutions operate under the Colleges Act and the Technical Institutes Act. They are not subject to the controls and constraints imposed on departments and most Provincial agencies by the Financial Administration Act, nor are they required to adhere to the requirements and guidelines for controlling and accounting for resources prescribed in the Treasury Department's Manual of Financial Administration. The philosophy underlying this arrangement is that these board-governed educational institutions should be allowed a degree of financial autonomy.

In 1979-80 and for several years thereafter, the Auditor General reported to the Legislative Assembly on a variety of both pervasive and individual concerns arising from the annual audits of the colleges. Many of those concerns have been addressed since then by individual colleges, though some still remain. Nevertheless, management letters issued to the individual colleges and technical institutes still contain more accounting and financial control observations and recommendations than is consistent with institutions that are financially well administered. For example, seven 1985-86 management letters contained observations and recommendations related to control exercised over computer resources and computer processed data, and the inadequate segregation of clerical and administrative duties to reduce the likelihood of fraud and error.

Another area of concern has been a lack of consistency in the way that the colleges and technical institutes account for and report their financial activities. Some have a history of employing, at times, unacceptable accounting policies in preparing their annual financial statements. Four of the Auditor General's audit reports on 1985 financial statements of public colleges contained reservations of opinion because of unacceptable accounting policies and reporting practices. Some of the other accounting policies used by the colleges, while technically acceptable, are not ideal, nor are they consistently used from college to college.

The Auditor General's concerns and recommendations have been considered by the colleges and technical institutes and, sometimes with the assistance of the Audit Office, changes have been adopted to improve accounting and financial controls. The adoption by all institutions of the financial statement presentation guidelines published by the Canadian Association of University Business Officers has largely eliminated, for 1986, the need for reservations in audit reports. However, even this new financial statement format has not eliminated all reporting anomalies and inconsistencies.

It is possible that, in the absence of central guidance, the institutions have progressed as far as they can towards achieving consistency in their accounting and financial control procedures. The Auditor General believes that the Department of Advanced Education, as the major source of funding to public colleges and technical institutes and a major user of the information in their financial statements, should provide the required central guidance.

It would seem that there are benefits to be derived from the public colleges and technical institutes adopting common standards and guidelines for controlling their financial and other resources, common policies for accounting for their activities, and common reporting practices and formats for their annual financial statements. Not only would this promote improved and more consistent accounting and financial control procedures, it would also enable the financial activities of the colleges and technical institutes to be compared one with another.

In the management letter to the Deputy Minister at the conclusion of the Department's 1985-86 audit, the Auditor General made the following recommendation:

Recommendation No. 5

It is recommended that the Minister of Advanced Education initiate, in conjunction with the Department of Advanced Education, the public colleges and the technical institutes, the development of formal standards and guidelines to promote more effective internal control and accounting systems and more consistent financial reporting for colleges and technical institutes.

Follow-up of Previous Annual Report Recommendations

Investment of surplus funds — In his 1984-85 annual report (section 3.4.10), the Auditor General commented on the desirability of allowing all Provincial agencies to invest their temporarily surplus funds in the Province's Consolidated Cash Investment Trust Fund (CCITF).

Similar comments were expressed in the 1979-80, 1982-83 and 1983-84 annual reports, chiefly in relation to the Province's public colleges and technical institutes. These entities operate under legislation which precludes them from investing in the CCITF. As such, any funds they receive or hold which are surplus to immediate requirements can only be placed with chartered banks or other institutions specified in the prevailing legislation.

Over the years, audits have revealed instances where colleges and technical institutes have foregone interest revenue because of ineffective investment practices. Sometimes this was because high yield investment opportunities could not be found which provided the requisite amount of security and liquidity. In other instances, small entities had insufficient staff to devote the time and attention needed to manage an effective investment strategy.

Although some institutions have effective investment practices, it is believed that the CCITF is an ideal investment vehicle for monies held by colleges, technical institutes and similar small and medium sized Provincial agencies. It is a fund administered by the Treasury Department which pools the funds of a number of approved depositors in order to maximize the investment yield available to each depositor, while at the same time providing daily liquidity. In other words, it provides the money management expertise that smaller Provincial agencies may lack or lack the time to practice.

In his 1984-85 annual report, the Auditor General again recommended that legislative changes be effected to allow appropriate Provincial agencies the option of utilizing the services of the CCITF. Subsequently, in a report to the Public Accounts Committee, the Provincial Treasurer agreed with the Auditor General's proposal. However, as of the date of this report, no enabling legislative changes have been made.

In a management letter to the Deputy Minister of Advanced Education, the Auditor General made the following recommendation:

Recommendation No. 6

It is recommended that the Minister of Advanced Education seek amendments to the Colleges Act and the Technical Institutes Act to allow Provincially-owned colleges and technical institutes to invest in the Consolidated Cash Investment Trust Fund.

2.4.2 Financial audits of the following were also completed:

Advanced Education Endowment Fund - year ended March 31, 1986
John Joseph Collett Memorial Scholarship Fund - year ended March 31, 1986
Students Loan Fund - year ended March 31, 1986

2.4.3 **Students Finance Board** — year ended March 31, 1986

The annual financial audit was extended to include the following:

— A review of the potential impact of the destruction of data or programs, or the non-availability of processing facilities, at the data processing bureau used by the Board.

— A review of the systems and procedures used by the Board to verify the accuracy and completeness of information provided for student loan applications.

— A review of the procedures and controls used to approve and disburse emergency loans to students.

— A review of the systems and procedures used by the Board to verify the accuracy of the information received from banks relating to loan balances and repayments.

2.4.4 UNIVERSITIES, THE BANFF CENTRE AND RELATED ENTITIES

The Provincially-owned universities, the Banff Centre and related entities operate under the authority of the Universities Act and the Banff Centre Act. The financial statements of these Provincial agencies are not published in the public accounts, nor are they included in the Province's consolidated financial statements. The Auditor General has commented on this in section 2.2.1 of this report. However, the Minister of Advanced Education, who administers the aforementioned Acts, tables the audited financial statements of these agencies each year in the Legislative Assembly.

2.4.5 **The University of Alberta** — year ended March 31, 1986

Observations from Financial Audit Work

Certain departments of the University need to improve the way they record and control the revenues they bill. In addition, the University's capital equipment accounting records also need improving.

For example, the 1985-86 annual audit revealed that revenues from housing and food services were not adequately accounted for or controlled. The subsidiary receivables ledger was not balanced promptly, and reconciliation differences between the subsidiary ledger and the general ledger control account were not investigated and cleared within reasonable periods. One result of this situation was that a significant year-end adjustment was needed to agree the housing and food services subsidiary ledger to the Comptroller's general ledger. At March 31, 1986, approximately 40% of amounts due to the University for housing and food services billings had been outstanding for one year or longer.

In a management letter to the University's Vice President (Administration) at the conclusion of the audit, the Auditor General recommended that the general ledger control account be reconciled monthly to the Housing and Food Services subsidiary ledger by the Comptroller's Office and that any reconciling items be investigated and cleared promptly.

In response to this recommendation, the University has since indicated that appropriate action has been taken to correct these control weaknesses. This action will be reviewed during the 1986-87 audit.

Previous annual audits have concluded with the Auditor General expressing concern over the adequacy of the procedures and records used by the University to control and account for capital equipment. Currently, the University's Capital Equipment Advisory Committee is reviewing these problems with a view to improving the accuracy of the accounting and equipment records.

During the 1985-86 audit it was observed that differences continued to occur between the records of capital equipment acquisitions in the general ledger maintained by the Comptroller's Office and the equipment inventory records maintained by Technical Services. It was also noted that inappropriate estimates of costs were again used when deleting disposals of equipment from the accounting records.

In the management letter to the University's Vice President (Administration) at the conclusion of the audit, the Auditor General made the following recommendation:

Recommendation No. 7

It is recommended that the Capital Equipment Advisory Committee of The University of Alberta continue with its efforts to improve the accuracy of the accounting and equipment records, and release its recommendations in time for the related problems to be resolved prior to the end of the next fiscal year. It is also recommended that the Comptroller's Office obtain reliable cost estimates for equipment disposals to avoid mis-statement of asset values.

2.4.6 **The University of Calgary** — year ended March 31, 1986

Observations from Financial Audit Work

The University needs to improve the way it accounts for and monitors the provision of analytical services to outside users and temporarily financed capital projects.

The University provides and charges for analytical services to the public. Instead of accounting for the costs and revenues associated with these services as part of its general operations, the University has for several years accounted for many of them through its restricted fund accounts. One result of this is that any profits or losses are not reflected in the University's operating results, but are deferred on the balance sheet.

In the management letter to the University's Vice-President (Finance and Services) at the conclusion of the audit, the Auditor General again expressed concern as to the appropriateness of the method used to account for analytical services provided to outside users. He noted in particular an absence of consistent policies and procedures governing the accounting for non-arm's length transactions, the disposition of any profits, and the responsibility for any over-commitments or losses. Accordingly, he made the following recommendation:

Recommendation No. 8

It is recommended that The University of Calgary establish appropriate accounting policies for analytical services provided to outside users that can be followed by all departments of the University that provide such services.

The University responded to this recommendation by stating that it is finalizing a policy covering overcommitments and overexpenditures for all restricted fund accounts. Further, guidelines governing outside professional activity regarding non-arm's length transactions are now part of the collective agreement between the University and the Faculty Association. The extent to which these guidelines address the Auditor General's recommendation will be reviewed during the 1986-87 audit.

The University finances internally a number of capital projects using undesignated capital funds. These funds are grants received from the Province to be used for unspecified capital purposes. The financing of these projects is intended to be temporary, usually in the form of a loan to be repaid out of future departmental operations or from outside financing when favourable terms can be obtained.

During the 1985-86 audit, it was observed that the status of temporarily financed capital projects was not being reported regularly to the Board of Governors to enable it to monitor and address accumulating costs and replacement financing. In one instance, an internal loan of more than $3 million to finance the acquisition of a computer remains outstanding because anticipated cash flows from the sale of computer software had not materialized.

In the management letter to the University's Vice-President (Finance and Services) at the conclusion of the audit, the Auditor General recommended that University Management report regularly, at least annually, to the Board of Governors on the status of capital projects temporarily financed out of undesignated capital funds, so that the Board can consider alternative ways of refinancing these projects when necessary. In its reply to the management letter, the University agreed with this recommendation and stated that such a report was provided to the Board in September 1986.

2.4.7 **The Banff Centre for Continuing Education** — year ended March 31, 1986

The annual financial audit was extended to include an examination of the system and procedures used by certain departments of the Banff Centre to monitor the use of human resources in the delivery of the Centre's programs.

Observations from Extended Audit Work

The audit concluded that the Centre's Operations, Planning and Support Services Department has satisfactory systems to monitor and control the use of its human resource costs and needs.

The School of Fine Arts, however, is one department where improvements could be made in this regard.

The School has not developed and established reliable manpower utilization standards against which operating costs can be monitored and variances therefrom investigated. The importance of investigating and controlling these costs is emphasized by recent increases in per-student costs and statistics produced by the Centre which show wide variances in costs per full time equivalent students in different programs.

There also appears to be potential for better cost control, and perhaps cost savings, by improving the timeliness and form of the planning and budgeting for the School's stage productions. Instances were observed where inadequacies in the planning process appear to have contributed to considerable overtime being paid. Production budgets did not contain the degree of detail which could facilitate the determination of whether actual costs were reasonable in the circumstances.

In the management letter to the Centre's President at the conclusion of the audit, the Auditor General made the following recommendations:

Recommendation No. 9

It is recommended that the School of Fine Arts of The Banff Centre for Continuing Education:

- *develop and establish appropriate manpower utilization standards,*
- *improve and formalize the planning and budgeting process for stage productions,*
- *compare detailed theatre production costs with budgeted costs on a production-by-production basis, investigating any significant variances, and*
- *develop systems for determining the optimum allocation of time between formal instruction and work on productions, that is consistent with the desired quality of student instruction.*

2.4.8 **Chembiomed Ltd.** — year ended March 31, 1986

Observations from Financial Audit Work

The audit revealed that a number of improvements could be made in the procedures and records used by the Company to control and account for inventories of raw materials and finished products, work in process, accounts receivable, purchasing, travelling expenses, fixed assets and patents.

Many of the deficiencies observed were typical of a company whose financial and management control systems have failed to keep pace with the rapid growth in its operations. These deficiencies are serious at present and have the potential, if not corrected, to affect adversely the control exercised by Management, particularly if the Company continues to grow at the present pace.

In the management letter to the Chairman of the Board of Directors at the conclusion of the audit, the Auditor General made a number of detailed recommendations, which the Company is addressing, for improving the Company's financial and management control systems.

2.4.9 **Hydrocarbon Research Centre** — years ended March 31, 1985 and 1986

Observations from Financial Audit Work

Completion of the audit of the Centre's financial statements for the year ended March 31, 1985 was delayed until October 1986. This was mainly due to uncertainties concerning the proper disposition of funds remaining unexpended following completion of a contract for the Department of Energy and Natural Resources. These uncertainties still have not been fully resolved, and this has delayed the completion of the audit of the Centre's financial statements for the year ended March 31, 1986.

In the management letter to the Centre's Chairman at the conclusion of the March 1985 audit, the Auditor General made the following recommendation:

Recommendation No. 10

It is recommended that the Hydrocarbon Research Centre seek immediately, in conjunction with the Department of Energy, to resolve the existing uncertainties and agree on the amount, if any, that the Centre owes to the Department.

2.4.10 Financial audits of the following were also completed:

Athabasca University - year ended March 31, 1986
The University of Lethbridge - year ended March 31, 1986
The Alberta Microelectronic Centre - year ended March 31, 1986
The Arctic Institute of North America - year ended March 31, 1986
Academic Pension Plan Fund of the University of Alberta - year ended December 31, 1985 and the period ended October 31, 1986

2.4.11 PUBLIC COLLEGES

The Provincially-owned public colleges operate under the authority of the Colleges Act. There were ten public colleges at June 30, 1985 and another, the Alberta College of Art, commenced operations on July 1, 1985. Although these colleges are Provincial agencies, their financial statements are not published in the public accounts, nor are they included in the Province's consolidated financial statements. However, the Minister of Advanced Education, who administers the Colleges Act, tables the audited financial statements of the Colleges each year in the Legislative Assembly.

2.4.12 **Fairview College** — years ended June 30, 1985 and 1986

The financial audit work was extended to include a review of the adequacy of the controls incorporated into and associated with a new in-house computer system.

Observations from Financial Audit Work

When Fairview College was established as a board-governed public college in 1978, the Department of Advanced Education transferred to it ownership of all furnishings and equipment physically located at the College. Neither the Department nor the College, however, had a complete record of these assets and their values. In the management letter to the College's President at the conclusion of the 1978-79 audit, and in each succeeding annual management letter to the 1984-85 audit, the Auditor General recommended that steps be taken to address this problem.

Meanwhile, the College reflected these assets on its annual balance sheets at a nominal value of one dollar. This had the effect of understating significantly the value of the College's fixed assets. For this reason, the Auditor General's reports on the College's financial statements for the years ended June 30, 1979 through 1985 contained reservations of opinion.

In the management letter to the College's President at the conclusion of the June 1985 audit, the Auditor General again recommended that preparing proper fixed asset records be assigned a high priority, and that verification and control procedures be performed to ensure that the records are accurate and complete.

The June 1986 audit revealed that a comprehensive record of all of the College's fixed assets had been completed. Furthermore, the value of fixed assets were properly disclosed on the College's balance sheet at June 30, 1986. Accordingly, the Auditor General's report on the College's June 1986 financial statements contained no reservation of opinion.

2.4.13 **Grande Prairie Regional College** — years ended June 30, 1985 and 1986

Observations from Financial Audit Work

In common with other public colleges, Grande Prairie Regional College provides student residence and similar services that are ancillary to the College's normal educational operations. These ancillary services are expected to generate sufficient revenue to cover related maintenance and fixed asset replacement costs.

The June 1985 audit revealed that the College had adopted the policy of accounting for the operating surplus on its student residence operations, both as an operating expenditure and as an increase to the unexpended capital funds available for future maintenance and replacement costs. In other words, the College's financial statements showed that the student residence operations broke-even, since the operating expenditures for student residences were inflated by a transfer, representing the surplus for the year, to the College's general capital funds. The surplus was thereby set aside for student residence maintenance and replacement costs.

This accounting and reporting practice increases artificially the College's annual operating expenditures, and could lead to future maintenance costs for the student residence operations being incorrectly capitalized.

In the management letter to the College's President at the conclusion of the June 1985 audit, the Auditor General recommended that the College report only the actual annual expenditures of the student residence operations, and then appropriate any operating surplus to a student residence reserve.

The June 1986 audit revealed that the College has accepted and implemented the Auditor General's recommendation.

2.4.14 **Keyano College** — years ended June 30, 1985 and 1986

During 1986, an employee was found by Management to have stolen money from the College. Although the exact amount stolen has not been determined, the employee admitted to taking $4,000, and has repaid this amount to the College. The employee has since been charged and convicted of theft.

2.4.15 **Lethbridge Community College** — years ended June 30, 1985 and 1986

The financial audit work was extended, at the College's request, to include a review of the existence and adequacy of the internal controls within the food services department, and a

review of the effects on internal controls of a proposed change in the procedures for issuing computer generated cheques.

Follow-up of Previous Annual Report Recommendations

During the years ended June 30, 1984 and 1985, the College transferred significant amounts from operating funds to restricted funds. These transfers (1984 — $550,000: 1985 — $520,238) were reported in the College's financial statements as deductions before arriving at the surpluses for those years. This form of reporting is considered to be an inappropriate departure from generally accepted accounting principles. Transfers of this nature cannot be considered normal annual operating transactions and, accordingly, should be reported as transfers or appropriations of operating surplus. A related audit observation is that future expenditures charged to these transferred funds will likely not appear in the annual statements of operating revenue, expenditure and surplus, thereby distorting operating results of future years.

The Auditor General's reports on the financial statements of the College for the years ended June 30, 1984 and 1985 contained reservations of opinion because the statements had not been prepared in accordance with acceptable accounting principles.

In a management letter to the College's President at the conclusion of the June 1985 audit, the Auditor General recommended that significant transfers of funds to capital or restricted funds be reported as transfers of operating surplus, rather than as annual operating expenditures, in the College's annual financial statements.

A related recommendation was included in the Auditor General's 1984-85 annual report to the Legislative Assembly (section 3.5.8).

The June 1986 audit revealed that the College has accepted and implemented the Auditor General's recommendation. Accordingly, a related reservation of opinion on the financial statements for that year was unnecessary.

Observations from Financial Audit Work

In common with other public colleges, Lethbridge Community College provides student residence and similar services that are ancillary to the College's normal educational operations. These ancillary services are expected to generate sufficient revenue to cover related maintenance and fixed asset replacement costs.

The June 1985 audit revealed that the College had a policy of accounting for student residence operations in the statement of restricted funds transactions rather than in the statement of revenue, expenditure and operating surplus. This accounting and reporting practice artificially decreases the College's annual operating revenues and expenditures. In the management letter to the College's President at the conclusion of the June 1985 audit, the Auditor General recommended that the College report the actual annual expenditures of the student residence operations in the statement of revenue, expenditure and operating surplus, and that any operating surplus be appropriated to a student residence reserve.

The June 1986 audit revealed that the College has accepted and implemented the Auditor General's recommendation.

2.4.16 **Medicine Hat College** — year ended June 30, 1985

The financial audit was extended, at the College's request, to include a review of the existence and adequacy of the internal controls in the new electronic data processing systems implemented for processing financial information.

Follow-up of Previous Annual Report Recommendations

During the years ended June 30, 1984 and 1985, the College transferred significant amounts from operating funds to restricted funds. These transfers (1984 — $958,979: 1985 — $947,343) were reported in the College's financial statements as deductions before arriving at the surpluses for these years. This form of reporting is considered to be an inappropriate departure from generally accepted accounting principles. Transfers of this nature cannot be considered normal annual operating transactions and, accordingly, should be reported as transfers or appropriations of operating surplus. A related audit observation is that future expenditures charged to these transferred funds will likely not appear in the annual statements of operating revenue, expenditure and surplus, thereby distorting operating results of future years.

The Auditor General's reports on the financial statements of the College for the years ended June 30, 1984 and 1985 contained reservations of opinion because the statements had not been prepared in accordance with acceptable accounting principles.

In a management letter to the College's President at the conclusion of the June 1985 audit, the Auditor General made the following recommendation:

Recommendation No. 11

It is recommended that Medicine Hat College report the board-created restricted funds as reserves, report as revenue the interest earned on these funds, and report charges to these funds as expenditure. Transfers to and from the reserves should appear on the statement of revenue, expenditure and operating surplus after the surplus or deficit for the year has been determined. This form of financial reporting would disclose more appropriately the magnitude of college operations and the annual operating results.

2.4.17 **Mount Royal College** — years ended June 30, 1985 and 1986

The financial audit work was extended, at the College's request, to include a review of the existence and adequacy of the internal controls in the system of project management for the major expansion of facilities.

Follow-up of Previous Annual Report Recommendations

The Auditor General's report on the financial statements of the College for the years ended June 30, 1984 and 1985 contained reservations of opinion because the statements had not been prepared in accordance with acceptable accounting principles. The College had not removed from the fixed asset accounts the original cost or fair market value of assets disposed of or considered of no further value or use. The amount of proceeds from fixed asset disposals had been credited to (removed from) the accounts. The College's accounting treatment of asset disposals resulted in a significant, but unknown, overstatement of fixed assets.

In a management letter to the College's President at the conclusion of the 1985 audit, the Auditor General recommended that generally accepted accounting principles be adhered to for the recording of fixed assets in the general ledger and the fixed asset sub-ledger, and that all fixed assets be appropriately tagged for identification and subject to periodic physical verification.

The June 1986 audit revealed that the College has accepted and implemented the Auditor General's recommendation. Accordingly, a related reservation of opinion on the financial statements for that year was unnecessary.

2.4.18 **Olds College** — year ended June 30, 1985

The financial audit work was extended to include a review of the existence and adequacy of the internal controls in the new in-house computer system implemented by the College during the year.

The College suffered two cases of employee theft during the years ended June 30, 1985 and 1986. In 1985, Management discovered that an employee had fraudulently obtained funds from the College amounting to approximately $12,000. The employee was charged and convicted of theft. The College has applied to its insurers for reimbursement of the amount stolen. In 1986, Management discovered that another employee was involved in cash irregularities. The employee was charged with theft, and was subsequently convicted of wilful mischief. Losses to the College were estimated at $600.

2.4.19 Financial audits of the following were also completed:

Grant MacEwan Community College - years ended June 30, 1985 and 1986
Lakeland College - years ended June 30, 1985 and 1986
Red Deer College - years ended June 30, 1985 and 1986

2.4.20 TECHNICAL INSTITUTES

The Northern Alberta Institute of Technology, the Southern Alberta Institute of Technology and the Westerra Institute of Technology all operate under the Technical Institutes Act. Although they are Provincial agencies, their financial statements are not published in the public accounts, nor are they included in the Province's consolidated financial statements. However, the Minister of Advanced Education, who administers the Technical Institutes Act, tables the audited financial statements of the institutes each year in the Legislative Assembly.

2.4.21 **Northern Alberta Institute of Technology (NAIT)** — years ended June 30, 1985 and 1986

The annual financial audit was extended to include an examination of the systems used to provide Management with the information on which NAIT's annual operating plan is based, and the process by which the annual budget is formulated.

Observations from Extended Audit Work

Many of NAIT's planning and budgeting information systems are well developed and provide valuable and useable information. For example, systems are in place to identify current and future manpower requirements, to identify student demand for training, and to enable Management to determine the suitability of alternative approaches to course delivery. Annual operating budgets are prepared at the departmental level and consolidated for NAIT as a whole. However, information produced by these systems is not brought together into a comprehensive annual plan in which the budget is closely related to the plan for program delivery. Without this close relationship it is difficult to ensure that program delivery is achieved in the most efficient and effective manner, having regard to physical, personnel and financial constraints. Such an annual plan could assist in optimizing the Institute's use of resources and could assist Management in meeting NAIT's training objectives and determining the degree to which those objectives are met.

The examination also concluded that NAIT could benefit from refining its central costing function. Such a function would be responsible for obtaining direct costs from departments, for combining direct costs with indirect central costs, for costing preferred courses of instruction and alternatives, and translating the aggregate cost of all courses planned into an annual

operating budget. It would also maintain historical data on student enrollment, budgeted costs, actual costs and budget variances. This would allow individual costs to be monitored against student levels so that the way that each expense varies according to student levels can be established and trends identified.

Recommendation No. 12

It is recommended that the Northern Alberta Institute of Technology:

— *prepare a comprehensive annual plan for each academic year to assist in meeting the stated objectives of the Institute, having regard to physical, human and financial constraints. This process will assist the Institute in meeting its training objective and will help Management in determining the degree to which the objective has been met, and*

— *refine the central costing process to cost each planned course, to maintain records of cost behaviour, and to analyze cost trends.*

In his reply to the Auditor General's management letter concerning a comprehensive annual plan, the Institute's President indicated that initiatives currently being taken by the Institute are designed to permit economic considerations to exert a stronger influence on program development planning.

The Institute does not agree that the central costing system should include all indirect costs to provide full absorption costing similar to systems used in the private sector. The Institute therefore intends to continue developing a system for direct costs only. The Auditor General, however, believes that indirect costs form a substantial portion of overall costs and should therefore be included in the costing system.

It is expected that the development and refinement of the systems necessary to prepare comprehensive annual plans will take a number of years. It is clear, however, from the steps already taken that the Institute is in general agreement with the Auditor General's recommendations. Future audits of NAIT will review these developments.

Follow-up of Previous Annual Report Observation

In his 1984-85 annual report, the Auditor General reported that during the audit for the year ended June 30, 1985, it was discovered that serious expenditure irregularities appear to have occurred at the Institute involving a senior official. The former official is no longer employed by the Institute and, due to the nature of the irregularities, the matter is being resolved by senior officials of the Institute in consultation with the Department of the Attorney General.

2.4.22 **Southern Alberta Institute of Technology (SAIT)** — years ended June 30, 1985 and 1986

Observations from Financial Audit Work

Following observations and recommendations during the June 1984 audit, Management reviewed the Institute's inventories and decided that the values involved warranted including inventory values in the annual financial statements. Unfortunately, however, inventories were not counted and valued at June 30, 1985, and Management's estimates of inventory values at that date had to be used for financial statement reporting purposes. Since inventory values were not available for June 30, 1984 either, it was decided that the total (estimated) value of additional inventories should be disclosed as contributed surplus in the June 1985 financial statements, thereby eliminating the effect of year-end inventories from that year's operating results.

In the management letter to the Institute's President at the conclusion of the June 1985 audit, the Auditor General recommended that, in future, inventories be counted and valued at or close to

fiscal year-ends so that reliable inventory values could be included in the Institute's annual financial statements.

SAIT performed a comprehensive count and valuation of its inventories in June 1986. The count was generally satisfactory, though some problems arose with the accuracy and completeness of the count.

In the management letter to the Institute's President at the conclusion of the June 1986 audit, the Auditor General recommended that, in future, the Institute promote more accurate and complete counts of its year-end inventories by issuing clear and comprehensive instructions to all involved. He also recommended that Management review any differences between inventory levels shown by perpetual inventory records and inventory levels revealed by physical counts.

In response to this recommendation, the Institute's President has indicated that, before June 30, 1987, a comprehensive plan will be developed which will address the concerns raised during the audit.

The Auditor General's reports on the financial statements of the Institute for the years ended June 30, 1985 and 1986 both contained reservations of opinion because the Auditor General was unable to satisfy himself concerning inventory values at June 30, 1984 and 1985.

2.4.23 A financial audit of Westerra Institute of Technology was also completed for the year ended June 30, 1985.

2.5 AGRICULTURE

Of the matters reported to management, the observations and recommendations below are those which the Auditor General considers should be brought to the attention of the Legislative Assembly.

2.5.1 **Department of Agriculture**— year ended March 31, 1986

The annual financial audit was extended to include a review of the adequacy of management and financial controls necessary and in place for the administration of the Alberta Feed Grain Market Adjustment Program and the Alberta Red Meat Interim Insurance Program.

Observations from Extended Audit Work

Alberta Feed Grain Market Adjustment Program — The Department is not obtaining adequate assurance that grants paid under this Program are based on actual consumption of grain by eligible livestock. Furthermore, there is considerable scope for improving the way that the Department obtains and evaluates the evidence needed to provide adequate assurance.

The Program is a means of offsetting the distortion in feed grain prices which livestock producers face as a result of the current method of paying the federal "Crow benefit" directly to the railways. Under the Program, livestock producers received grants totalling $33 million during the 1985-86 fiscal year.

The Department carries out certain checks to verify the accuracy of the amounts claimed prior to disbursements being made. The primary assurance, however, that the amounts claimed are reasonable is obtained by subsequent field audits conducted by the Department.

During the Audit Office's review of the Department's field audit procedures, it was observed that the Department had not determined the level of assurance that it expects to achieve, nor had it developed procedures for evaluating the assurance provided by field audits. In addition, although information concerning feed grain and livestock on hand was obtained during field audits, there was insufficient evidence to support the reasonableness of grain consumption claimed. The Audit Office concluded that field audits should be designed to reconcile the opening grain inventory plus additions through home grown supplies or purchases supported by certificates less reasonable consumption, considering eligible livestock levels, with the closing grain inventory.

In a management letter to the Deputy Minister at the conclusion of the 1985-86 audit, the Auditor General made the following recommendation:

Recommendation No. 13

> *It is recommended that the Department of Agriculture specify the level of assurance it desires to achieve from field audits of grants paid under the Alberta Feed Grain Market Adjustment Program, and upgrade the audit procedures used to provide this assurance.*

Alberta Red Meat Interim Insurance Program — Deficiencies existed in the systems and procedures established to handle the payment of grants to livestock producers.

The purpose of the Program introduced in October 1985 was to assist livestock producers retroactively for the period of depressed selling prices — April 1, 1985, to September 30, 1985. Under the Program, eligible livestock producers received grants totalling $43 million.

During the Audit Office's review, instances were observed where a data entry control was being bypassed. The number of approved eligible slaughtered animals was to be used as a batch input

control when the claims details were entered into the computer system. Established procedures were not, however, being followed inasmuch as the manually calculated batch total of slaughtered animals was not always being compared to the total generated by the computer system.

Instances were also observed where the number and the type of animals were inaccurately recorded, each resulting in under and overpayments. In some cases the inaccuracies resulted from a failure to identify incomplete supporting documentation to a claim prior to entering the claim in the computer system.

It was also noted that there had been inadequate communication with the systems consultants during the design and initial implementation stages of the Program resulting in some Program users' requirements not being properly addressed. Program support staff had not been adequately trained to perform the duties required and there was inadequate management supervision of and guidance for Program staff.

Although this Program has ended, the Auditor General made the following recommendation in a management letter to the Deputy Minister at the conclusion of the 1985-86 audit, in the belief that the administration of future grant programs can be improved by learning from the problems experienced with past programs:

Recommendation No. 14

It is recommended that, in future, when new grant programs are introduced by the Department of Agriculture:

— *every effort be made to ensure that established procedures are followed, and*

— *appropriate senior management staff are adequately involved in planning, defining and documenting procedures, and all staff be suitably trained and supervised.*

2.5.2 **Alberta Agricultural Development Corporation** — year ended March 31, 1986

The annual financial audit was extended to include audit procedures necessary to support the issue of an auditor's report on the separate financial statements of "Lambco, a division of Alberta Agricultural Development Corporation" for the year ended March 31, 1986.

2.5.3 **Alberta Hail and Crop Insurance Corporation** — year ended March 31, 1986

Observations from Financial Audit Work

Recoverable advances made from the Province's General Revenue Fund to the Corporation during 1985-86 totalling $161.6 million appear to have exceeded the authority provided by the Hail and Crop Insurance Act.

The Corporation operates pursuant to the Hail and Crop Insurance Act to indemnify Alberta farmers for damage to crops by hail and other risks. Under section 43 of the Act, the Province has entered into a Crop Insurance Agreement with the Government of Canada to, in effect, guarantee certain of the Corporation's insurance activities. This Agreement covers such matters as:

(i) the types of crops that are insurable, the insurable risks, the extent of coverage, and the premium rates to be charged;

(ii) a commitment by the Government of Canada to contribute to the Corporation an amount based on the crop insurance premiums collected from farmers;

(iii) a commitment by the Province and the Government of Canada each to set aside a "reinsurance" fund to hold a fixed portion of the premiums collected by the Corporation; and

(iv) a formula whereby the Province and the Government of Canada will indemnify the Corporation for any amounts by which the claims paid exceed its crop insurance reserves. Such indemnification is not to be limited to the amounts held in the "reinsurance" funds.

Section 35(5) of the Act allows the Corporation to obtain advances from the Province's General Revenue Fund equal to the amount to be received from the Government of Canada under the Crop Insurance Agreement (see (ii) and (iv) above), but not exceeding $30 million. Section 35(4) of the Act allows the Provincial Treasurer to advance money voted by the Legislature for the Corporation's administration expenses and for Alberta's share of premiums on contracts falling outside the terms of the Crop Insurance Agreement. No other legislative provisions appear to authorize the payment of advances to the Corporation from the General Revenue Fund.

During the year ended March 31, 1986, pending reimbursement from the reinsurance funds of the Province and Canada, the Corporation obtained advances totalling $161.6 million from the General Revenue Fund to finance the amount by which claims paid exceeded its insurance reserves. Although these advances were financed by Special Warrants, they cannot provide an authority which overrides existing legislation. Of the amount advanced, approximately $117.5 million was in lieu of amounts receivable from the Government of Canada, approximately $37.5 million was in lieu of amounts receivable from the Province, and $6.6 million was an overadvance.

It appears that portions of the advances were without legislative authority because:

— the amount of approximately $117.5 million that related to amounts receivable from the Government of Canada exceeded the statutory limit of $30 million, and

— the $37.5 million in lieu of amounts receivable from the Province and the $6.6 million overadvance were not provided for by legislation.

A note to the Corporation's March 1986 financial statements acknowledges that certain of its advances from the General Revenue Fund were without legislative authority.

Recommendation No. 15

It is recommended that the Alberta Hail and Crop Insurance Corporation ensure that in future its advances from the General Revenue Fund not exceed the limits imposed by the Hail and Crop Insurance Act. If the limit imposed by the Act is believed to be unduly restrictive, consideration should be given to seeking a legislative amendment to increase the limit.

2.5.4 Financial audits of the following were also completed:

Crop Reinsurance Fund of Alberta - year ended March 31, 1986
The Horned Cattle Purchases Act Trust Account - year ended March 31, 1986
Livestock Patrons' Assurance Fund - year ended March 31, 1986
Stray Animals Act Fund - year ended March 31, 1986
Alberta Agricultural Research Trust - year ended March 31, 1986
Alberta Dairy Control Board - year ended March 31, 1986
Irrigation Land Manager - year ended December 31, 1985
Agricultural Research Council of Alberta - year ended March 31, 1986
Alberta Terminals Ltd. - year ended July 31, 1985
Claude Gallinger Memorial Scholarship Fund - year ended March 31, 1986
Pennington Memorial Scholarship Fund - year ended March 31, 1986
Wheat Board Money Trust Account - year ended March 31, 1986

2.6 ATTORNEY GENERAL

Of the matters reported to management, the observations and recommendation below are those which the Auditor General considers should be brought to the attention of the Legislative Assembly.

2.6.1 **Department of the Attorney General** — year ended March 31, 1986

The annual financial audit was extended to include the following:

— An examination of the financial controls existing at the Court of Queens Bench and Provincial Court in Red Deer.

— An examination of financial controls existing at the Land Titles Offices in Calgary and Edmonton. This examination included a follow-up of control improvements instituted following the discovery of a fraud which was outlined in the Auditor General's 1984-85 annual report to the Legislative Assembly (section 3.4.11).

— A review of the management control systems used to administer the court services function of the Department's Court and Property Services Division.

— A review of the activities of the Internal Audit Branch to determine if it contributes appropriately to the Department's internal control systems and whether the Audit Office can rely on the audit work performed by the Branch.

Observations from Financial Audit Work

Control improvements are needed in the system and procedures used by the Department to receive, hold and disburse trust monies on behalf of the Province's courts.

The Department collects monies paid into Alberta courts, holds these monies in trust, and disburses them as required by statutes, regulations and court judgements. Approximately $30 million is collected and disbursed each year.

The Department has developed a system called the Court Administration Project (CAP) to record, control and account for these monies. During the 1985-86 audit, it was observed that the CAP collection and disbursement system accounts were not in agreement with the related bank accounts. Further investigation revealed that the bank accounts had not been reconciled properly to the CAP system records since March 1983. This situation constitutes a serious weakness in the control exercised over these trust monies.

In a management letter to the Deputy Minister at the conclusion of the audit, the Auditor General made the following recommendation:

Recommendation No. 16

It is recommended that the Department of the Attorney General reconcile monthly the records maintained by the Court Administration Project System used to control collections and disbursements of trust monies with the related bank accounts, and that these reconciliations be reviewed by senior Departmental officers.

2.6.2 Financial audits of the following were also completed:

Public Trustee - year ended December 31, 1985
Chattel Security Registries Assurance Fund - year ended March 31, 1986
Registrar's Assurance Fund - year ended March 31, 1986
The Alberta General Insurance Company - year ended December 31, 1985
Fines and Costs Distribution Trust - year ended March 31, 1986
Land Titles Office — Calgary - year ended March 31, 1986
Land Titles Office — Edmonton - year ended March 31, 1986
Maintenance Enforcement Trust - year ended March 31, 1986
Various Courts and Sheriffs' Offices - year ended March 31, 1986

2.7 CONSUMER AND CORPORATE AFFAIRS

2.7.1 Of the matters reported to management, there were no observations which the Auditor General considers should be brought to the attention of the Legislative Assembly with respect to the financial audits of the following:

Department of Consumer and Corporate Affairs
Collection Practices Act Trust
Debtors Assistance Trust
Insurance Companies Trust
Orderly Payment of Debts
Securities Act Trust

All of these were audited for the fiscal year ended March 31, 1986.

2.8 CULTURE

Of the matters reported to management, the observations below are those which the Auditor General considers should be brought to the attention of the Legislative Assembly.

2.8.1 **Department of Culture** — year ended March 31, 1986

The annual financial audit was extended to include a review of the appropriateness and quality of the systems used by the Department to authorize payments of individual grants for Vote 2 (Cultural Development), Vote 3 (Historical Resources) and Vote 5 (Heritage Development) for 1985-86.

2.8.2 **The Alberta Historical Resources Foundation** — year ended December 31, 1985

Observations from Financial Audit Work

The Auditor General's report on the financial statements of the Foundation contained a reservation of opinion because, as explained in section 3.2.2 of this report, the Foundation receives donation revenue which is not susceptible of audit verification.

2.8.3 **Glenbow-Alberta Institute** — year ended March 31, 1986

The annual financial audit was extended to include the following:

- A review of the systems and procedures used to record the acquisition of and to safeguard artifacts donated to and purchased by the Institute.
- The issue of auditor's reports on the separate financial statements of:
  - Glenbow Foundation,
  - Luxton Museum Ltd.,
  - Luxton Museum, a department of Glenbow-Alberta Institute.
- The issue of auditor's reports on expenditure statements for nine of the Institute's projects and programs.

Observations from Financial Audit Work

The Auditor General's report on the financial statements of the Institute contained a reservation of opinion because, as explained in section 3.2.2 of this report, the Institute receives donation revenue which is not susceptible of audit verification.

2.8.4 Financial audits of the following were also completed:

Culture Revolving Fund
The Alberta Art Foundation
The Alberta Cultural Heritage Foundation
The Alberta Foundation for the Literary Arts
The Alberta Foundation for the Performing Arts
The Government House Foundation
Fort Dunvegan Historical Society Trust Fund
New Canadian Encyclopedia Publishing Ltd. Trust Fund

All of these were audited for the fiscal year ended March 31, 1986.

2.9 ECONOMIC DEVELOPMENT

Of the matters reported to management, the observations below are those which the Auditor General considers should be brought to the attention of the Legislative Assembly.

2.9.1 **Department of Economic Development** — year ended March 31, 1986

The annual financial audit was extended to include a review of the adequacy of the systems and procedures used to administer the Small Business Equity Corporation Program and to monitor compliance with the legislative authorities under which the Program operates.

Observations from Extended Audit Work

Small Business Equity Corporation Program — The program commenced in May 1984. It was administered by the then Department of Small Business and Tourism until responsibility for it was transferred to the Department of Economic Development (now Economic Development and Trade) in February 1986. Formal compliance verification procedures were not established until several months after the program became operational. The Department subsequently initiated an extensive review of Small Business Equity Corporation investments, and it is understood that some concerns arising from this exercise remain to be resolved. These concerns will be followed up during future audits.

2.9.2 Financial audits of the following were also completed:

Motion Picture Development Fund - year ended March 31, 1986
Alberta Motion Picture Development Corporation - year ended March 31, 1986
Alberta Opportunity Company - year ended March 31, 1986
Alberta Intermodal Services Ltd. - period ended December 31, 1985

2.10 EDUCATION

Of the matters reported to management, the observations and recommendations below are those which the Auditor General considers should be brought to the attention of the Legislative Assembly.

2.10.1 **Department of Education** — year ended March 31, 1986

The annual financial audit was extended to include the following:

— An examination of the financial and administrative systems in place at the Correspondence School at Barrhead.

— A review of the mandate, structure and operating methodologies of the Department's Internal Control Unit and an assessment of the Unit's work on the enrollment statistics used to disburse school operating grants.

— A review of the methods used by the Department's Edmonton Regional Office to assess its role and effectiveness in verifying student enrollment statistics.

2.10.2 **School Book Branch** — year ended March 31, 1986

The annual financial audit was extended to include a review of the Branch's electronic data processing (EDP) acquisition and implementation plans and proposed operational procedures.

Observations from Extended Audit Work

Deficiencies continue to exist with respect to EDP activities at the School Book Branch (now called the Learning Resources Distributing Centre).

The acquisition and implementation of EDP capability at the Branch has been of concern to the Audit Office for several years. The Office has commented to Management upon EDP deficiencies, which have not been resolved fully, since 1980. Furthermore, the Evaluations Section of the Office of the Controller, Treasury Department, performed reviews and reported similar deficiencies to Management in 1981 and 1984.

In 1985, the Branch acquired and installed a new mini-computer. Management's involvement with this acquisition was closer than with previous acquisitions and as a result there was a prompt recognition of problems with the implementation of systems on the new computer. Subsequently, a major review of the total operations of the Branch, including EDP, was launched by Management and the Audit Office has been assured that EDP and financial control deficiencies will be resolved.

In the management letter to the Deputy Minister at the conclusion of the 1985-86 audit, the Auditor General made the following recommendation:

Recommendation No. 17

It is recommended that Senior Management of the Learning Resources Distributing Centre of the Department of Education;

— *review closely the Centre's electronic data processing (EDP) activities and provide advice and direction for the development and implementation of new systems and for the operation of existing systems at the Centre,*

— *not undertake any further expansion of EDP facilities until the deficiencies in the present system are resolved, and*

— *resolve known deficiencies in EDP controls during the current review of the Centre's total operations.*

2.10.3 **Teachers' Retirement Fund** — year ended August 31, 1985

Follow-up of Previous Annual Report Recommendations

In his 1984-85 annual report (section 3.3.9), the Auditor General reported that honoraria paid to a member of the Board of Administrators of the Teachers' Retirement Fund (TRF Board) contravened the Teachers' Retirement Fund Act. He also reported that a resolution of the TRF Board relating to the retention of directors' fees by members of the TRF Board may also have led to a contravention of the Act.

Receipt of remuneration by members of the TRF Board is dealt with in section 5 of the Teachers' Retirement Fund Act. This section states that "members of the Board shall serve without remuneration, but they shall be paid out of the Fund their proper expenses, including travelling expenses incurred in the course of their duties."

The Auditor General described the circumstances in which the honoraria and fees were paid, and stated that he had obtained legal opinions which support his belief that the Act has been contravened. He concluded by recommending that honoraria not be paid to members of the TRF Board out of the Teachers' Retirement Fund, and that all honoraria that have been received by a member for serving on the Fund's Investment Committee be repaid to the Fund. He further recommended that the TRF Board request the Treasury Board to formulate a general management policy and issue a directive with respect to directors' fees received by board members of Provincial agencies from corporations in which the Provincial agencies are shareholders.

In a report to the Public Accounts Committee, the Provincial Treasurer responded to the Auditor General's recommendations by stating:

> "When the Teachers' Retirement Fund Board (TRF Board) became aware that there is some doubt as to whether or not there is legislative authority for the practice of paying honoraria to its members, the practice was stopped. The TRF Board will seek an amendment to the Teachers' Retirement Fund Act that would give the Lieutenant Governor in Council authority to remunerate TRF Board members for their services at the same rate that members of other government pension boards are remunerated.
>
> It is not clear that the Teachers' Retirement Fund Act prohibits members of the Teachers' Retirement Fund Board (TRF Board) from retaining directors' fees they receive from corporations as a result of being nominated by the TRF Board to the boards of the corporations. However, to eliminate any possibility that the retention of these fees by TRF Board members might bring their interests into conflict with the interest of the TRF Board, an amendment to the Teachers' Retirement Fund Act will be sought that will require these fees to be paid to the TRF. The TRF Board adopted this policy from March 12, 1986."

This response effectively satisfies the Auditor General's concerns.

2.10.4 **School Foundation Program Fund** — year ended March 31, 1986

The annual financial audit was extended to include a review of the processes used by the Fund to verify student enrollment and transportation statistics.

Observations from Extended Audit Work

The Department of Education needs to improve the way that it verifies the reliability of enrollment and transportation data used as a basis for disbursing funding from the School Foundation Program Fund.

Partly in response to earlier audit recommendations, the Department's Internal Control Unit has begun to develop guidelines and procedures, in conjunction with the Program Delivery Division, governing the verification of enrollment data collected from school jurisdictions. This data is used to calculate funding provided from the School Foundation Program Fund to public and separate school boards.

The 1985-86 audit revealed that the development of the enrollment information verification process was not complete, and that the criteria used to select the schools whose enrollment information would be verified resulted in seventy percent of the schools not being considered for selection. It was also noted that no procedures were in place to verify the reliability of the urban transportation statistics on which urban transportation grants are calculated.

In the management letter to the Deputy Minister at the conclusion of the Fund's audit, the Auditor General made the following recommendation:

Recommendation No. 18

It is recommended that the Department of Education:

— *finalize its guidelines and procedures for the enrollment information verification process and that all school jurisdictions be available for selection, and*

— *develop and implement appropriate guidelines and procedures to verify urban transportation statistics.*

2.10.5 Financial audits of the following were also completed:

Federal French Language Grants Fund - year ended March 31, 1986
School for the Deaf Donations - year ended March 31, 1986
School for the Deaf Pupils Trust - year ended March 31, 1986
Mildred Rowe Weston Estate Trust - year ended March 31, 1986
Northland School Division No. 61 - year ended December 31, 1985

2.11 ENERGY AND NATURAL RESOURCES

Of the matters reported to management, the observations and recommendations below are those which the Auditor General considers should be brought to the attention of the Legislative Assembly.

2.11.1 **Department of Energy and Natural Resources** — year ended March 31, 1986.

The annual financial audit of the Department (now called the Department of Energy) was extended to include the following:

— Auditing the financial records of the Syncrude Project for compliance with the Alberta Crown Agreement and related accounting manual, and examining the determination of deemed net profit of the Project.

— An examination of the information used by the Department to monitor and account for oil and gas production, oil and gas royalties, mineral taxes, and incentives, to determine the reliability of that information.

Observations from Extended Audit Work

Alberta Crown Agreement - Syncrude Project — Pursuant to the Alberta Crown Agreement under which the Syncrude Project operates, the Audit Office has for many years carried out audit work on the Project's financial records. The main purpose of this work, which was performed on behalf of the Province, has been to obtain assurance that the deemed net profits of the Project and the Province's royalty share are determined as required by the Alberta Crown Agreement. Each year, the Audit Office has prepared for the Minister's signature a "challenge" letter summarizing expenditures which are not in accordance with the terms of the Agreement. Under the Agreement, the challenge letter is issued two years after the period being reported on.

In 1986, following an amendment to the Alberta Crown Agreement that was ratified by all parties thereto, and discussions between the Audit Office and the Department, it was agreed that in future the audit work outlined above would be performed by the Department. This was confirmed in October 1986 in a memorandum from the Auditor General to the Minister in which it was agreed that the challenge letter for the year ended December 1984 would be prepared by the Audit Office, and that subsequent challenge letters will be prepared by the Department.

Oil and Gas Production Data — Oil and gas production figures on which Provincial oil and gas royalty revenues are based are not properly monitored and verified by the Department to determine whether they are sufficiently reliable for that purpose.

The Department is responsible for collecting and accounting for the Province's oil and gas royalty and mineral tax revenues. In discharging this responsibility it uses oil and gas production data obtained from the Energy Resources Conservation Board (ERCB) and the oil and gas industry. Some of this data is forwarded to the Alberta Petroleum Marketing Commission (APMC) which markets oil on behalf of the Crown. APMC uses the data to determine whether the Province has received the oil royalty share of production as determined by the Department.

Royalties for oil and gas are calculated differently. Oil royalties are calculated on well production, while gas royalties are calculated on sales. The calculation of both, however, relies heavily on the oil production data and the gas and gas by-products disposition data, largely provided by ERCB. Both calculations also encompass regulated benefits (which apply at a well level) and include special royalty rates, low productivity adjustments and royalty holiday programs. Similarly, mineral tax is calculated using production data provided by the ERCB and also involves benefits at the well level.

Accordingly, the accuracy and completeness of the data supplied by ERCB to the Department is vital, since it is the major component of the information used by the Department to:

— calculate oil royalties and mineral tax, and

— verify the accuracy of gas royalties calculated on the royalty returns submitted to the Department by the gas industry.

During 1986, the Audit Office examined the methods used by ERCB to collect, accumulate and report the production and related data used by the Department for royalty and tax calculation and verification purposes. As a result of this examination, it was concluded that the Department is not justified in accepting ERCB production and related data, without obtaining assurance that it is accurate enough for the Department's purposes.

At present, ERCB collects and accumulates production and related data mainly for its own purposes. It does not attempt to verify the data to the level of accuracy needed to calculate and verify royalties and mineral taxes. The production facilities visited by ERCB field inspectors are selected using criteria designed to obtain assurance that the facilities are complying with ERCB's policies and regulations. Such a sample is unsuitable for arriving at a conclusion on the overall reliability of the production data collected.

The Audit Office concluded that the files prepared by ERCB's field inspectors to document their visits to processing facilities contained insufficient evidence related to:

— the inspectors' findings and conclusions,

— any follow-up procedures employed,

— the results of action taken, and

— supervisory review of the files.

It was noted that the procedures performed by ERCB on monthly production reports did not include the checking of calculated prorated production or the mathematical accuracy of proration factors. Checking the accuracy of these calculations is relevant in determining production allocated to wells. It was also noted that current month's proration factors were not compared to previous months on a regular basis. Analytical review of this nature may reveal unusual or irregular trends which may indicate errors in calculation, reporting or measurement.

In 1985, ERCB undertook a Test Data Verification Project. This involved obtained evidence of well production tests from certain well operators, and comparing it with the production data obtained from monthly production reports also submitted to ERCB by well operators. This data is used in determining proration factors which are used when allocating production to wells. Significant errors were discovered in the data which resulted in adjustments to prorated production.

In the management letter to the Chairman of ERCB at the conclusion of the 1986 audit, the Auditor General made the following recommendations:

Recommendation No. 19

It is recommended that the Energy Resources Conservation Board:

— *develop and implement procedures to supplement its existing program of field inspections to enable the Board to determine the overall accuracy of the production and related data that it collects and reports to the Department of Energy,*

— *retain, in an organized manner, such working papers and documentation as are necessary to evidence the work of field inspectors,*

— *give priority to incorporating procedures to check the calculation of prorated production and of proration factors into the computer programs currently being developed. Furthermore, procedures should be established to compare and analyse monthly proration factors to identify significant changes or unusual trends, and*

— *require operators to submit test data documentation, on a selective basis, for comparison with the data reported on monthly production reports, until such time as the reporting problems are minimized.*

The Auditor General also summarized the audit conclusions and recommendations outlined above in his management letter to the Deputy Minister at the conclusion of the Department's 1985-86 audit. He stated that, in his opinion, the Department would experience difficulty obtaining a reasonable degree of assurance that the information currently being obtained from ERCB and used to calculate and verify royalties, mineral taxes and incentives, is sufficiently accurate for that purpose.

The Department clearly recognizes that using accurate production data is fundamental to its determination of royalties, mineral taxes and incentives. Subsequent to the issue of a previous management letter to the Board on April 22, 1986, a task force was formed to investigate and make recommendations on this issue. The task force is made up of representatives from the Department, ERCB and APMC. The Audit Office fully supports the establishment of the task force and has been monitoring its deliberations.

In the latest management letter on this subject to the Deputy Minister, the Auditor General made the following recommendation:

Recommendation No. 20

It is recommended that the Department of Energy take steps to ensure that the task force comprising representatives of the Department, the Energy Resources Conservation Board and the Alberta Petroleum Marketing Commission addresses:

— *the Department's accuracy requirements relating to the production data supplied to the Department by the Board,*

— *the extent and nature of field inspections required by the Board to satisfy those accuracy requirements,*

— *the selection criteria to be used by the Board when deciding which production facilities to inspect, and*

— *how errors or inaccuracies detected by field inspectors should be defined and evaluated to arrive at an overall conclusion concerning the reliability of the production data reported.*

Follow-up of Previous Annual Report Recommendations

In his 1981-82 annual report, the Auditor General commented on deficiencies and inaccuracies in the control systems and data used by the Department to collect and account for the Province's share of royalties from natural gas and natural gas by-products. Subsequent annual reports have described the Department's progress towards eliminating those problems. The 1984-85 annual report acknowledged that the Department had developed a comprehensive new computer-based system to record, monitor and control these royalty revenues, and had begun to implement parts of the system.

The 1985-86 audit included a review of the finalization and implementation of the new mineral revenue system. Although some conversion and similar problems remain to be resolved, it

appears that the system will obviate the concerns previously expressed by the Auditor General on the adequacy of the system it is replacing.

In the management letter to the Deputy Minister at the conclusion of the audit, the Auditor General acknowledged the Department's significant achievement in implementing major portions of the new system during 1985-86, and the improved control accorded thereby.

In previous annual reports, the Auditor General also reported that the Department was considerably in arrears in verifying the accuracy of the royalties it has received. The 1985-86 audit revealed that some of these verification procedures still had not been performed on royalties received for 1983 and 1984. Since then, however, these arrears have been reduced and the Department is confident that they will be eliminated by the end of 1986. The Audit Office has reviewed the Department's plans in this regard and will complete its review of the action taken during the 1986-87 audit.

Further concerns that arose from the 1985-86 audit associated with the mineral revenue system and its related data are reported below.

Observations from Financial Audit Work

Reporting and reconciling natural gas royalties — The Department is unable to reconcile promptly the volumes of gas reported by gas processing facilities with the volumes reported by the owners of the gas wells, and thus is not gaining reasonable assurance that the Province is receiving promptly the royalty to which it is entitled.

Volumes of natural gas and natural gas by-products available for sale (VAS) are reported to the Department each month by gas processing facilities. The facilities allocate VAS to the owners of the gas wells who, in some cases, re-allocate it to sub-owners. These owners and sub-owners report their VAS to the Department each month on royalty returns which specify their royalty liability.

If the owners report their VAS accurately and promptly, the above reporting requirements enable the Department to reconcile the owners' VAS to the VAS reported by processing facility operators. This provides assurance that all monthly royalty returns have been received.

During the 1985-86 audit, it was observed that some processing facilities and numerous owners were not reporting VAS to the Department promptly. Some processing facilities had not reported their VAS allocations for the early months of 1985, by May 1986. Furthermore, a portion of the VAS that had been allocated and reported to the Department had not been accounted for by owners on their monthly royalty returns. These problems have hindered considerably the Department's efforts to reconcile VAS. In May 1986, the Department had been unable to reconcile the VAS figures for the previous sixteen months for approximately three quarters of the Province's gas processing facilities.

This situation diminishes considerably the assurance available to the Department that the information reported to it by the processing plants and well owners is accurate and complete. It also diminishes the Department's available assurance that it is receiving all of the royalty to which the Province is entitled.

In the management letter to the Deputy Minister at the conclusion of the audit, the Auditor General made the following recommendation:

Recommendation No. 21

It is recommended that the Department of Energy take the action necessary to ensure that natural gas and by-products volumes and related royalties are reported, reconciled and recorded promptly.

Old/new gas and pentanes — The Department is not verifying that the figures for "old" and "new" gas and pentanes, on which royalty is calculated and paid, are accurately stated on the royalty returns submitted by the gas industry.

Old gas is gas that was discovered prior to 1974. New gas is gas that was discovered since then, and on which a lower royalty rate is payable.

Monthly royalty returns, which accompany royalty payments from gas well owners, show whether the gas on which the royalty is calculated is old gas or new gas. The mineral revenue system does not verify that old gas and new gas are correctly described, even though the system's data base contains the information that would enable it to do so.

During the 1985-86 audit, the Audit Office recalculated the royalties received for 1985 gas sales using the old/new gas information on the mineral revenue system's data base. This recalculation indicated that royalties received for that year may have been insufficient by as much as $9 million, as a result of the information reported by the gas industry being incorrect. Further enquiry revealed that the mineral revenue system has a program for checking automatically whether the gas reported is old or new, but that the program had not been implemented.

In the management letter to the Deputy Minister at the conclusion of the audit, the Auditor General made the following recommendation:

Recommendation No. 22

> *It is recommended that, in order to verify whether the split between old and new gas is reported correctly for royalty calculation purposes, the Department of Energy activate the program within the mineral revenue system designed to perform this verification.*

System design weaknesses — There are design weaknesses in the incentives sub-system of the Department's new computer-based mineral revenue system.

The incentive sub-system contains automatic controls designed to prevent legislatively imposed limits (dollar amounts and time periods) on drilling incentives being exceeded. These controls operate on a data base record which stores cumulatively by licence number, the monetary amounts and time periods allowed as incentives. During the 1985-86 audit, it was observed that the cumulative monetary amounts stored on the data base were unreliable since, for some licences, they did not agree to the sum of the monthly incentives allowed. The record of time periods was also found to be unreliable, apparently because of difficulties encountered when converting data from the old system to the new.

It was also observed during the audit that the sub-system was unable to process correctly amendments to the information on the data base resulting from reporting entities refiling monthly royalty returns. The amended incentives allowed were not being automatically corrected on the data base on which the aforementioned limiting controls are designed to operate.

The system design weaknesses described above do not appear to have resulted in incentive limits being exceeded. If allowed to persist, however, limits may be exceeded.

In the management letter to the Deputy Minister at the conclusion of the audit, the Auditor General recommended that the design weaknesses identified in the incentives sub-system of the mineral revenue system be eliminated.

Exploratory Drilling Incentive Program (1984) — The Department is administering the Program in a manner which could result in unexpected and unintended liabilities to the Province.

The regulations under which the Program operates limit the royalties that can be foregone as royalty holidays to $2 million per well. Where wells are owned by several royalty payers, it seems

equitable that royalty payers should be entitled to share in the available royalty holidays only to the extent of their participating interest in the wells.

Currently, the Department allocates royalty holidays, or parts thereof, to the royalty payers who claim them first. Inherent in this method is the danger that the Department may allow some royalty payers to claim more than their share of available holidays, thereby leaving it potentially liable in the event that the other royalty payers claim their shares.

In the management letter to the Deputy Minister at the conclusion of the audit, the Auditor General made the following recommendation:

Recommendation No. 23

It is recommended that the Department of Energy establish procedures to ensure that a claimant's participating interest in a royalty holiday does not exceed his participatory interest in a well, unless other participants have waived their rights to claim.

2.11.2 **Alberta Petroleum Marketing Commission** — year ended December 31, 1985

The annual financial audit was extended to include procedures necessary to issue an auditor's opinion on a schedule of receipts and payments relating to the New Oil Reference Price and Special Old Oil Price Programs.

Follow up of Previous Annual Report Recommendations

In his 1984-85 annual report (section 3.3.1), the Auditor General reported that the Commission lacked, in some areas, properly documented policies and procedures relative to its responsibilities for administering the Natural Gas Pricing Agreement Act Fund and the Petroleum Marketing Act.

The audit for the year ended December 31, 1985 revealed that systems documentation had been improved considerably and that efforts to update policies and procedures documentation were continuing.

Observations from Financial Audit Work

The 1985-86 annual audit identified a situation where the Commission had undertaken administrative functions on behalf of the Minister of Energy and Natural Resources without appropriate legislative authority.

On behalf of the Minister, the Commission conducted buy-sell transactions under the Ethane Feedstock Price Equalization Program. These transactions were aimed at ensuring that producers of ethane by-products had access to natural gas feedstock at prices equal to the average price for intra-Alberta industrial gas. Funding for this program was provided by the Department of Energy and Natural Resources. The program commenced in April 1985 and covered transactions during the period from November 1, 1984 to June 30, 1986.

The terms of the program were contained in two agreements to which the Province, though not the Commission, was a party. A legal opinion obtained by the Auditor General indicates that the Commission lacks the authority to undertake the aforementioned transactions on behalf of the Province.

A note to the Commission's audited financial statements for the year ended December 31, 1985 acknowledges that there appears to be no express authority in Alberta statutes for the Commission to perform administrative functions under the terms of the two agreements entered into by the Province.

These observations were reported to Management at the conclusion of the audit. A related recommendation is not appropriate in this report, however, since the Ethane Feedstock Price Equalization Program has now been discontinued.

2.11.3 Financial audits of the following were also completed:

Alberta Oil Sands Technology and Research Authority - year ended December 31, 1985
Alberta Petroleum Incentives Program Fund - year ended March 31, 1986
Natural Gas Pricing Agreement Act Fund - year ended December 31, 1985
Natural Gas Pricing Agreement Market Development Fund - year ended December 31, 1985

2.12 ENVIRONMENT

Of the matters reported to management, there were no observations which the Auditor General considers should be brought to the attention of the Legislative Assembly.

2.12.1 **Department of Environment** — year ended March 31, 1986

The annual financial audit was extended to include the following:

- An examination of the internal controls in the system used by the Department to control and account for expenditures on the Oldman River Dam, irrigation headworks and main irrigation system improvements.

- An examination of the financial accounting and control system used to account for revenues from water power rentals.

2.12.2 Financial audits of the following were also completed:

Water Resources Revolving Fund - year ended March 31, 1986
Alberta Environmental Research Trust - year ended December 31, 1985
Alberta Special Waste Management Corporation - year ended March 31, 1986
Environment Council of Alberta - year ended March 31, 1986
Surface Reclamation Fund - year ended March 31, 1986

2.13 EXECUTIVE COUNCIL

Of the matters reported to management, the observations and recommendations below are those which the Auditor General considers should be brought to the attention of the Legislative Assembly.

2.13.1 **The Wild Rose Foundation** — year ended March 31, 1986

Observations from Financial Audit Work

The Wild Rose Foundation paid grants which contravened, or appear to have contravened, the limitations imposed by the Wild Rose Foundation Act and Alberta Regulation 16/85.

Section 3 of the Wild Rose Foundation Act allows the Foundation to pay grants to volunteer non-profit organizations that provide necessary and valuable community services to Albertans. This section, however, prohibits the Foundation from providing funding for services or programs that are within the objects of one or more of the following:

- Alberta Sport Council
- The Recreation, Parks and Wildlife Foundation
- The Alberta Art Foundation
- The Alberta Cultural Heritage Foundation
- The Alberta Foundation for the Performing Arts
- The Alberta Foundation for the Literary Arts
- The Alberta Historical Resources Foundation
- Any organization that receives grants from the Western Canada Lottery Foundation

The 1985-86 annual audit revealed instances where grants were paid to fund services or programs which fell within the objects of one or more of the above entities.

Instances were also noted where grants were paid to individuals. This practice was "approved" by the Members of the Foundation by a motion which "Resolved that members of the Wild Rose Foundation construe the meaning of the word "organization" as included in Section 3 of the Wild Rose Foundation Act to include individuals." This motion, however, is ineffectual since the Members lack the authority to revise a legislative restriction imposed on the Foundation by the Wild Rose Foundation Act.

The 1985-86 annual audit also revealed instances where grants were paid which lacked proper approval by Foundation Members. Payment of these grants was approved by a Subcommittee which consisted of two Foundation Members and the Executive Director of the Foundation. However, the Wild Rose Foundation Act does not expressly provide for the delegation of authority to approve grants. In the absence of such power to delegate, grants must be approved at a properly constituted meeting of the Members of the Foundation. Since the Subcommittee did not consist entirely of Foundation Members, or a quorum of Foundation Members, grants approved by it were paid without the requisite legislative authority.

The audit also revealed instances where Foundation Members had not complied with Alberta Regulation 16/85, issued pursuant to section 6(2) of the Wild Rose Foundation Act. This Regulation states in section 2 that:

> "Unless otherwise provided by a term or condition of any gift, bequest or devise, the Foundation shall not give a grant to an organization
>
> (a) that exceeds the amounts received by that organization through community fund raising activities undertaken by the organization, or
>
> (b) that exceeds $30,000."

This section appears to mean that grants paid must be matched by funds raised by the recipient organization, and that grants must not exceed $30,000. The audit revealed that although no grants were paid which exceeded the $30,000 limit, many were paid where matching funds had not been raised by the recipient organization. The authorization to approve payment of these grants was provided by a motion of the Foundation Members which states:

> "The Members of the Wild Rose Foundation construe the wording of item 2 of the Wild Rose Foundation Regulations to mean that no grant shall exceed $30,000 and that the matching principle be not necessarily applied."

This motion suffers the same disability as the one referred to above. Foundation Members do not have the authority to ignore or alter a restriction imposed by the Regulation. Accordingly, grants paid where matching funds had not been raised by the recipient organization were paid without legislative authority.

The 1985-86 annual audit also revealed that the Foundation paid a grant to cover the wages of an employee of a grant recipient. A grant of this nature contravenes section 1(a) of the Regulation which states that:

> "The Foundation shall not give grants to organizations
>
> (a) that are to be used for payment of salaries or for providing internal operating expenditures."

A legal opinion obtained by the Auditor General supports his view that the situations described above constitute non-compliance with the prevailing legislation.

The many instances of non-compliance with legislative authorities revealed by the audit illustrate the difficulties being experienced by the Foundation in operating within the confines of its legislation. Furthermore, section 3 of the Wild Rose Foundation Act requires the Foundation to examine and interpret the objects of fifteen entities (seven listed in section 3 of the Act plus eight others receiving grants from the Western Canada Lottery Foundation) before approving grants. The objects of these organizations are often broad and open to more than one interpretation. Hence it is difficult for the Foundation to be sure that it is operating strictly within the restrictions imposed by section 3 of the Act. The Foundation will likely continue to encounter difficulties until its granting practices and/or the legislative requirements are suitably amended.

A note to the Foundation's March 1986 financial statements acknowledges that certain of its expenditures may lack proper legislative authority.

In the management letter to the Foundation's Chairman at the conclusion of the audit, the Auditor General recommended that:

— the Foundation adhere strictly to the terms of the Wild Rose Foundation Act and Alberta Regulation 16/85, and

— the Members approach the Minister responsible for administering the Act to seek clarification and, if appropriate, legislative amendments.

In a response to the management letter, the Foundation's Chairman indicated that a request to modify the Act has been presented to the Minister. Pending legislative changes, however, efforts will be made to avoid further non- compliance problems by closely scrutinizing grant applications to ensure that they meet the eligibility requirements of section 3 of the Act, by eliminating the sub-committee, and by rejecting applications for funding from individuals.

The Chairman also stated that he has obtained a legal opinion which indicates that the Act and Regulations can be interpreted as allowing the Foundation to pay grants to organizations under

Regulation 16/85, for which the recipient organization has not raised matching funding. Accordingly, the Foundation will continue to grant funding to organizations that have not raised matching funding. He further indicated that to be rigid on the matter of applications for funding containing the salary component of program and services would exclude many, if not most, worthy applications.

Recommendation No. 24

It is recommended that The Wild Rose Foundation seek amendments to the Wild Rose Foundation Act and related regulations, where necessary, to allow it to operate as intended and to eliminate uncertainties as to interpretation.

2.13.2 **The Workers' Compensation Board** — year ended December 31, 1985

The annual financial audit was extended, at the request of the Board, to include a review of the systems of procurement of data processing equipment and software.

Observations from Extended Audit Work

Due to design inadequacies and operational problems, the Board discontinued using a newly developed computer system only six weeks after it was put into operation.

A new on-line assessment system was implemented by the Board in October, 1985. Due to difficulties, however, the new system was withdrawn from service only six weeks later. As a result, assessable penalties were suspended and transactions for the period affected had to be reprocessed by restoring the previous batch assessment system. The Audit Office expressed concern about the decision-making process for the implementation of the new system since, due to a growing back-log in processing, the system was required to commence production prior to completion of testing at the program and systems levels. Other major problems noted were the lack of definition of responsibilities for user and system departments and inadequate monitoring of changes in system specifications.

In a management letter to the Board's Chairman at the conclusion of the audit, the Auditor General made the following recommendation:

Recommendation No. 25

It is recommended that, in future, The Workers' Compensation Board:

— *ensure that the responsibilities of all departments involved in systems development are clearly defined and changes in systems specifications are adequately documented and monitored, and*

— *ensure that all system components are tested in an integrated manner prior to implementation.*

2.13.3 Financial audits of the following were also completed:

Department of Executive Council
Personnel Administration Revolving Fund
Energy Resources Conservation Board
Long Term Disability Benefit Fund
Long Term Disability Benefit Fund — Bargaining Unit

All of these were audited for the fiscal year ended March 31, 1986.

2.14 FEDERAL AND INTERGOVERNMENTAL AFFAIRS

2.14.1 Of the matters reported to management, there were no observations which the Auditor General considered should be brought to the attention of the Legislative Assembly with respect to the financial audit of the Department of Federal and Intergovernmental Affairs for the fiscal year ended March 31, 1986.

2.15 FORESTRY

Of the matters reported to management, the observations and recommendation below are those which the Auditor General considers should be brought to the attention of the Legislative Assembly.

2.15.1 **Department of Forestry** — year ended March 31, 1986

For most of the 1985-86 fiscal year, the activities of what became the Department of Forestry (now called the Department of Forestry, Lands and Wildlife) were administered by the Department of Energy and Natural Resources. The annual financial audit was extended to include the following:

- An audit of the Province's 1985-86 claim under the Waterfowl Crop Damage Prevention cost-sharing agreement with the Government of Canada.
- A review of the systems and procedures used by the Department's Fish and Wildlife Division to:
  - monitor compliance with the governing legislative authorities of transactions and activities related to the wild fur industry, big game farms and game bird farms,
  - authorize and process information used for the payment of wages and salaries,
  - approve and control payments for personal expense claims, contract obligations, deferred purchase orders and standing offers in compliance with established policies, and
  - safeguard and account for fixed assets.

2.15.2 **Fish and Wildlife Trust Fund** — year ended March 31, 1986

Observations from Financial Audit Work

During 1985-86, a payment of $525,000 was made from the Buck for Wildlife Program Account of the Fish and Wildlife Trust Fund which did not comply with Alberta Regulation 277/85, subsection 4(2)(a).

The payment was to the Alberta Hail and Crop Insurance Corporation to cover insurance claims resulting from crop damage caused by wildlife. Subsection 4(2)(a) of the Regulation allows the Minister to make payments from the Buck for Wildlife Program Account to protect or enhance fish, wildlife or the habitats of fish or wildlife. Accordingly, the payment for crop damage did not comply with the purposes specified in the Regulation for the Buck for Wildlife Program Account.

The Buck for Wildlife Program Account is one of three accounts established by the Regulation as part of the Fish and Wildlife Trust Fund. The Regulation permits payments relating to crop damage caused by wildlife out of another program account called Wildlife Support. At the time the payment was required, however, no funds were available in this account.

The Department's legal counsel advises that section 7(2) of the Wildlife Act, S.A. 1984, c. W-9.1 (the new Wildlife Act) authorized the Minister to make the payment out of the Buck for Wildlife Program Account. This view is justified on the basis that section 7(2) gives the Minister the authority to "make payments out of the Fish and Wildlife Trust Fund for meeting any of the purposes for which the Fund is established". The Department's legal counsel views the regulations establishing and providing for payment from various separate accounts, i.e. the three program accounts of which Buck for Wildlife is one, as being merely of an administrative or directory nature and not detracting in any way from the authority of the Minister to make payments out of the Fund for any of its purposes.

In reviewing the advice of the Department's legal counsel, the Audit Office concluded that section 7(2) probably does permit a payment out of any of the three program accounts for any of the purposes specified in section 6 of the new Wildlife Act.

Section 6(b)(i) together with section 7(2) provide that the Minister can make payments providing compensation for damage or loss caused by wildlife, in accordance with prescribed programs. Section 1(1)(l) defines "prescribed" as meaning prescribed or otherwise provided for by regulations made by the Lieutenant Governor in Council. However, since section 1 has not yet been proclaimed, "prescribed" as defined in the Interpretation Act would appear to apply.

In the Interpretation Act "prescribed" is defined as "prescribed by or under the enactment in which the word occurs". There is no mention of the right of the Lieutenant Governor in Council to prescribe by regulation or otherwise and, therefore, section 96(1)(m) of the new Wildlife Act would not appear to authorize the Lieutenant Governor in Council to prescribe programs.

Further, if it is the intention of Legislation that the Lieutenant Governor should have the ability to restrict the power of the Minister by regulation, then such authority should be expressly stated in the statute and such does not appear to be the case.

If the apparent restrictions imposed by the Regulation are overridden by section 6 and 7(2) of the Act it is difficult to see the purpose of the Regulation.

If it is accepted that there are no prescribed programs, due to the fact that section 1 has not been proclaimed, then complications arise in the interpretation of such sections as 6(a) of the new Wildlife Act. Section 6(a) states that one of the purposes of establishing the Fish and Wildlife Trust Fund is for funding prescribed programs for the protection and enhancement of fish and wildlife in Alberta.

In the management letter to the Deputy Minister at the conclusion of the audit, the Auditor General made the following recommendation:

Recommendation No. 26

It is recommended that, in view of the apparent uncertainties concerning the meaning of Alberta Regulation 277/85 subsection 4(2)(a) and the term "prescribed programs" as used in the Wildlife Act S.A. 1984, c. W-9.1, consideration be given by the Department of Forestry, Lands and Wildlife to seeking appropriate legislative changes.

2.15.3 Financial audits of the following were also completed:

Forestry Revolving Fund
Forest Development Research Trust Fund
Homestead Lease Loan Fund
Junior Forest Ranger Program Fund

All of these were audited for the fiscal year ended March 31, 1986.

2.16 HOSPITALS AND MEDICAL CARE

Of the matters reported to management, the observations and recommendations below are those which the Auditor General considers should be brought to the attention of the Legislative Assembly.

2.16.1 **Department of Hospitals and Medical Care** — year ended March 31, 1986

The annual financial audit was extended to include the following:

— An examination of a selection of capital construction projects to determine whether they were administered in accordance with the Department's established construction project administration guidelines (the adequacy of which was evaluated during a previous annual audit).

— An examination of the Institutional Reporting Information System to assess its adequacy and the degree to which it satisfies the Department's information needs. The System is used to accumulate information which is used by the Department to control, monitor and account for annual operating grants to hospitals.

Follow-up of Previous Annual Report Recommendations

Capital funding for hospitals — In his 1983-84 annual report (section 2.3.1), the Auditor General described how two hospitals had intentionally issued inaccurate financial reports to obtain capital funding before such funding was due under the prevailing legislation. The Auditor General recommended in his 1983-84 and 1984-85 annual reports that the Department of Hospitals and Medical Care establish consultative arrangements - including liaison with the Treasury Department - to help resolve problems in connection with funding commitments that lapse at fiscal year-ends.

In March 1986, the Alberta Hospitalization Benefits Regulations were amended to allow the Minister to make payments in respect of approved capital equipment in whole or in part during the fiscal year in which the approval was given or in the fiscal year immediately following. The amendment also requires any hospital that receives an equipment grant to account to the Minister for the way in which the grant is spent and, if the full amount of the grant is not required, immediately return to the Provincial Treasurer the amount overpaid. Since this action will effectively resolve the Auditor General's reported concern in future, his recommendation is not repeated in this report. However, a similar situation occurred at March 31, 1986 and is reported below under the heading Alberta Childrens' Provincial General Hospital.

Accumulated interest on grants disbursed — In his 1984-85 annual report (section 3.4.5), the Auditor General reported that substantial amounts of interest were not being received by the Province as soon as they should have been and the Department of Hospitals and Medical Care was in arrears in performing capital construction project audits. This interest is earned on construction grant monies held, pending disbursement by hospital boards, in accounts maintained by the boards in the Province's Consolidated Cash Investment Trust Fund (CCITF). The Alberta Hospitalization Benefits Regulations, under which the grants are paid, do not allow the hospital boards to spend the interest they earn without the express approval of the Minister of Hospitals and Medical Care. Otherwise, the interest is repayable to the Department, usually after a construction project audit has been completed.

The 1985-86 annual audit revealed that the Department has taken steps to request the return of unspent monies so that interest earned on grant monies can be returned to the Province more promptly. The Department is also completing capital construction project audits more promptly. In a response to the Auditor General's 1984-85 recommendation, the Provincial Treasurer stated in a report to the Public Accounts Committee that as a result of the action taken, surplus interest earnings are now being recovered by the Department on an ongoing basis.

The Auditor General also recommended in his 1984-85 annual report that consideration be given to adopting a more informative way of disclosing in the public accounts monies held by hospitals over which the Province has power of disposition. He also suggested strengthening the legislative control and accountability over expenditures approved from interest earned by hospital boards on grant monies they receive from the Province.

In response to this recommendation, the Provincial Treasurer stated in a report to the Public Accounts Committee:

"The recommendation is rejected for the following reasons:

— Monies under a hospital board's jurisdiction should not be disclosed in the public accounts. A refund of the unexpended amount of a hospital capital project grant and interest earned on the grant is recognized as an amount receivable in the financial statements of the Province when the capital project is complete and the Province has claimed the refund. Interest cannot be recognized by the Province as an amount receivable before then, because the interest accrues to the hospital board and only when a project is complete is the Province entitled to claim unexpended interest.

— Legislative control and accountability are exercised over the original capital project grant. The condition that expenditures on capital projects from interest accruing to a hospital board on a capital grant are subject to the authorization of the Minister of Hospitals and Medical Care is a level of control not normally applied to interest on capital grants. As indicated by its rejection of the recommendation on legislative control over major capital projects (subsection 3.7.6), the Government believes that existing controls and accountability over capital projects are adequate for the safeguarding of public funds."

The Auditor General remains unconvinced that the aforementioned monies held by hospital boards are not public money and that they should not be reflected as such in the Province's public accounts. However, in view of the recent decrease in the amount of these monies held by hospital boards as a result of the action taken by the Department, these concerns, and the related concern as to the adequacy of the control exercised over disbursements from these monies, will be considered further during future audits.

2.16.2 **Health Care Insurance Fund** — year ended March 31, 1986

Follow-up of Previous Annual Report Recommendations

Alberta Blue Cross Plan — Some of the previously reported deficiencies in the financial control systems of the Health Care Insurance Fund persisted throughout 1985-86.

In his 1984-85 annual report (section 3.4.9), the Auditor General reported on deficiencies in the way that claims made to the Fund by the Alberta Blue Cross Plan are reviewed. The Fund reimburses the Plan for optional health services paid by the Plan on behalf of registrants who have arranged for optional health coverage with the Fund. For the year ended March 31, 1986 the reimbursements amounted to $87,146,000 (1985 — $74,416,000).

The Auditor General recommended that the Department of Hospitals and Medical Care exercise its rights under the agreement for optional health coverage by the Alberta Blue Cross Plan to examine the records of the Plan. Such examination could include periodic matches of the registration file with the records of the Health Care Insurance Fund as well as selective reviews of systems and controls. Further, it was recommended that claims paid by the Plan and reimbursed by the Fund be supported by computer tapes, and that regular procedures be established to balance these tapes and to test-verify individual claims. It was suggested that consideration should also be given to developing computer routines to check for reasonableness the claims paid by the Plan.

In a response to the Auditor General's 1984-85 recommendations, the Provincial Treasurer stated in a report to the Public Accounts Committee:

> "The Department intends to exercise its rights under the agreement for optional health coverage by the Alberta Blue Cross Plan (ABC) to examine the records of the Plan. Discussions with ABC have taken place and the matching of the ABC registration file with Health Care Insurance Fund records has been reinstated. The Internal Audit Branch is preparing an audit program to accomplish a review of ABC systems and controls that will take into account the work done by the ABC external auditors, and their audit certificate and comfort letter.
>
> Various means for the Department to check for reasonableness of the claims paid by ABC are under consideration including obtaining a reconciliation or balancing the computer tapes currently being supplied by ABC. The Accounting Branch is reviewing controls and procedures used for verifying payments by ABC."

Although the Department is acting on the Auditor General's recommendations, the deficiencies in the review of claims made to the Fund continued during the year ended March 31, 1986. Because of this and the magnitude of the reimbursements to the Plan, the Auditor General's management letter to the Deputy Minister at the conclusion of the audit again contained the following recommendation:

Recommendation No. 27

> *It is recommended that, in relation to the administration of the Health Care Insurance Fund, the Department of Hospitals and Medical Care:*
>
> — *take advantage of the provision in the agreement with the Alberta Blue Cross Plan for optional health coverage, which allows the Department to examine the records of the Plan. Such examinations should include periodic matches of the registration file with the records of the Fund, as well as selective reviews of systems and controls.*
>
> — *obtain computer tapes to support claims on the Fund by the Alberta Blue Cross Plan, and establish procedures to balance these tapes and to test-verify individual claims. Computer routines could also be developed to check the reasonableness of claims.*

In response to this recommendation, the Department has indicated that its Internal Audit Branch has begun an audit to be completed before the end of 1986-87. The response also indicated that progress is being made towards verifying claims and developing reconciliation procedures between payment tapes and amounts claimed.

Back logs of unprocessed claims — In his 1984-85 annual report (section 3.4.9), the Auditor General reported that the Fund experienced severe problems in processing a large backlog of claims. At times, override codes were used to by-pass computer edit checks so that claims could be processed more quickly.

The Auditor General recommended that the Department of Hospitals and Medical Care monitor volumes of unprocessed Health Care Insurance Fund claims and take immediate action to clear abnormal accumulations so that drastic measures, such as using override codes, become unnecessary.

In a response to the Auditor General's 1984-85 recommendation, the Provincial Treasurer stated in a report to the Public Accounts Committee:

> "The Department has improved its monitoring of unprocessed Health Care Insurance Fund claims and is taking appropriate immediate action to keep them to a minimum and avoid using override codes to clear any large accumulations. It is anticipated that the changes made in training of staff will also assist, as will relieving supervisors of production duties."

During the year ended March 31, 1986, however, further backlogs of unprocessed claims occurred and override codes were again used. These codes allow claims to be processed more quickly but certain checks designed to ensure that the transactions are valid are by-passed.

The Internal Audit Branch of the Department, as it does each year, examined a significant number of claims. The Audit Office examined the scope and results of the work performed by the Internal Audit Branch and noted that the Branch had detected incorrect payments to practitioners. In addition, instances were noted where attempts at recovery from The Workers' Compensation Board should have been made, but were not. Internal Audit attributed the errors to the use of override codes while the Department was trying to clear the backlog of claims. Based on the errors detected in the sample of claim payments examined, the Internal Audit Branch estimated that non-recovery from The Workers' Compensation Board and overpayments amounted to $4,200,000 in total.

Because the Department continued to use override codes in 1985-86 and because this resulted in overpayments, the Auditor General's management letter to the Deputy Minister at the conclusion of the audit again contained the following recommendation:

Recommendation No. 28

It is recommended that, in relation to the administration of the Health Care Insurance Fund, the Department of Hospitals and Medical Care take immediate action to clear abnormal accumulations of unprocessed claims and exercise extreme care when using override codes.

Statements of benefits — In his 1984-85 annual report (section 3.4.9), the Auditor General reported that annual statements of benefits forwarded by the Department to residents of Alberta were not being sent out within a reasonable period of time. These statements are prepared for payments to June 30, each year.

As the statements for the year to June 30, 1986 were sent out promptly, the Auditor General's recommendation regarding timeliness is not repeated.

Observations from Financial Audit Work

Preparation of financial statements — The Fund's financial statements for the year ended March 31, 1986 were finalized on July 31, 1986, which was over four months earlier than in prior years. The Auditor General complimented the staff of the Department on this significant achievement.

Registration — As part of the 1985-86 audit, the Audit Office expanded its use of computer assisted audit techniques in the examination of whether individuals were insured when services were provided. The audit revealed the following concerns:

— Recoveries of claim payments made on behalf of individuals whose registrations had been retroactively cancelled were not always attempted. In addition, review to determine whether payments were being made for services not provided was inadequate.

— The computer system automatically cancels a registration if the registrant is assumed to be no longer a resident of the Province. The criteria for the cancellation is no activity on the registration computer masterfile in the last six months. However, the cancellation is effected even though claims may have been paid on behalf of the registrant during the same six month period.

— Difficulties were experienced by the Department when attempting to match information relating to registrants' deaths provided by the Vital Statistics Branch, with information maintained by the Fund. Inaccurate dates of death can result in the Department unknowingly paying ineligible claims.

In the management letter to the Deputy Minister at the conclusion of the audit the Auditor General made the following recommendation:

Recommendation No. 29

It is recommended that, in relation to the administration of the Health Care Insurance Fund, the Department of Hospitals and Medical Care reassess the adequacy of its procedures for establishing the date of cancellation of a registration, and thoroughly investigate any claims paid with respect to services provided after that date.

2.16.3 **Alberta Urban Hospitals Project Management Ltd.** — year ended March 31, 1986

Observations from Financial Audit Work

This Company is incorporated under the Alberta Business Corporations Act. It has issued one share which is held in trust for the Minister of Hospitals and Medical Care. The sole business of the Company is to make payments on behalf of the Province for the design, construction, equipping and commissioning of two acute care hospitals; one in Edmonton and one in Calgary.

Because of the nature and ownership of the Company, it falls within the definition of a Provincial corporation as defined in section 1(1)(n) of the Financial Administration Act. As such, its operations are subject to the rules and constraints imposed by the Financial Administration Act. The audit revealed, however, that accounting officers had not been designated by the Company for approval by the Treasury Board, as required by the Financial Administration Act.

In the management letter to the Deputy Minister at the conclusion of the audit, the Auditor General recommended that the Department of Hospitals and Medical Care take steps to ensure that Alberta Urban Hospitals Project Management Ltd. complies with the requirements of the Financial Administration Act.

2.16.4 HOSPITALS

The Provincially-owned hospitals and their related foundations operate under the authority of the Provincial General Hospitals, Cancer Programs, University of Alberta Hospitals, University Hospitals Foundation Act and Mental Health Acts. The financial statements of these Provincial corporations are not included in the Public accounts, nor are the entities reflected in the consolidated financial statements of the Province. The Auditor General has commented on this matter in section 2.2.1 of this report. The Minister of Hospitals and Medical Care, who is charged with the administration of the above Acts, is required to table annually copies of these audited financial statements.

2.16.5 **Alberta Cancer Board** — year ended March 31, 1986

The annual financial audit was extended to include an examination of the system and procedures used by the Board to plan the development of electronic data processing (EDP) systems.

Observations from Extended Audit Work

The Alberta Cancer Board lacks an effective and co-ordinated strategy for identifying, developing and implementing new computer applications for its two major facilities - the Cross Cancer Institute and the Tom Baker Cancer Centre.

A major component of the Board's EDP strategies, developed by external consultants, is a central integrated approach to the development of new EDP systems. Pursuant to this policy, a director

of EDP systems was hired by the Board. He later resigned, however, due to an apparent lack of co-operation from the Board's major facilities.

The Cross Cancer Institute and the Tom Baker Cancer Centre continue to plan and implement new EDP systems independently without central co-ordination. This practice can easily result in the development of incompatible systems and higher overall development costs. Further, it does not conform to Board policy.

In the management letter to the Board's Executive Director at the conclusion of the audit, the Auditor General made the following recommendation:

Recommendation No. 30

It is recommended that the Alberta Cancer Board establish a central steering committee, with representatives from both major facilities, to identify areas where new electronic data processing applications could be justified and to direct the development and implementation of systems at all of the Board's facilities.

2.16.6 **Alberta Children's Provincial General Hospital**— year ended March 31, 1986

Observations from Financial Audit Work

The Hospital submitted falsified financial information in support of claims for capital funding from the Department of Hospitals and Medical Care.

The audit revealed that the Hospital had submitted to the Department of Hospitals and Medical Care three claims dated March 31, 1986, which contained amounts totalling $52,931 for equipment which had not been received by the Hospital by that date. These claims included certificates from a Hospital official which stated: "Certified above information correct, articles received, services performed, prices just and fair, do not include sales tax and have not been previously reimbursed." Copies of invoices were submitted to the Department to support the claims and, in one instance, it was noted that the Hospital had written to a supplier requesting invoices to be submitted to the Hospital in advance of the equipment delivery date.

As a result of these claims, the Department paid for 1986-87 equipment purchases out of funds appropriated by the Legislative Assembly for 1985-86. Although the claims were incorrect, it was not necessary to make any adjustment to the Hospital's March 31, 1986, financial statements. Since the equipment had not been received at that date, the Hospital had not reflected the equipment in its financial statements, nor did it reflect a receivable from the Department for the funding of the noted equipment.

The Hospital submitted the claims believing that the costs would not be reimbursed if the equipment was received after the year end. The approval for the acquisition of the equipment stipulated that "this approval expires March 31, 1986. If the purchase has not been completed by that date, grant commitments cannot be carried forward into the following fiscal period. Please submit your claim by March 31, 1986." As explained in section 2.16.1 of this report (Capital Funding for Hospitals) Regulations were amended in March 1986 to allow the Minister to make payments in respect of approved capital equipment in whole or in part during the fiscal year in which the approval was given or in the fiscal year immediately following. It appears that officials of the Hospital were unaware of the amended Regulations.

The Auditor General views with concern any situation in which inaccurate documents are issued intentionally in order to subvert expenditure controls.

Recommendation No. 31

It is recommended that the Alberta Children's Provincial General Hospital ensure that in future all claims for funding capital expenditures comply with the governing legislative authorities.

2.16.7 **Alberta Hospital Edmonton** — year ended March 31, 1986

The annual financial audit was extended to include a review of internal controls over the purchase, sale and recording of short-term investments.

Observations from Extended Audit Work

The review of short-term investments indicated that controls over the security and management of investments were satisfactory. It was noted, however, that the Hospital does not use the Consolidated Cash Investment Trust Fund (CCITF). The purpose of the CCITF is to pool the surplus funds of a number of depositors in order to maximize the investment yield available to each depositor while providing daily liquidity. As well, by providing centralized investment and other cash management services, the manpower requirements of the depositor for funds management are usually significantly reduced.

In a management letter to the Hospital's Executive Director, the Auditor General suggested that the Hospital discuss with the Treasury Department the advantages of using the Consolidated Cash Investment Trust Fund for investment of its surplus funds.

Follow-up of Previous Annual Report Recommendations

In his 1984-85 annual report (section 3.5.2), the Auditor General reported that the 1984-85 financial statements of the Hospital recorded interest earned on operating funds in an inappropriate manner. He recommended that the Hospital present fairly the Hospital's annual operating results by disclosing in its statements of revenue and expenditure all interest earned by the Hospital and, in accordance with the Mental Health Hospital Board's stated policy, appropriating each year an amount equal to interest earned on non-capital funds from revenue surplus to the special purpose fund.

In response to this recommendation, the Provincial Treasurer stated in a report to the Public Accounts Committee:

> "The Board of Directors of Alberta Hospital Edmonton are of the opinion that the Hospital's financial statements for the year ended March 31, 1985 presented fairly its annual operating results. All interest earned by the Hospital was reported in the financial statements or notes there- to which are an integral part of the financial statements. The method used to report discretionary revenue interest was similar to the method used by several major hospitals in Alberta audited by major Chartered Accountant firms. Accordingly, the Board is of the opinion that the Hospital's financial statements have been prepared in accordance with accounting principles generally accepted in the hospital industry.
>
> However, for the March 31, 1986 financial statements, all interest earned on operating funds will be included in the statement of revenue and expenditure and an appropriation will be made for an amount as determined by the Hospital Board's policy."

Since this action resolved the Auditor General's reported concern, his recommendation is not repeated in this report and a reservation of opinion on the 1985-86 financial statements of the Hospital, with respect to this matter, was unnecessary.

2.16.8 **Alberta Hospital Ponoka** — year ended March 31, 1986

Observations from Financial Audit Work

In his 1984-85 annual report (section 3.4.1), the Auditor General reported that following completion of the 1984-85 audit, Hospital officials discovered an apparent irregularity in the conduct of a senior Hospital employee. Investigation revealed that the employee had submitted for payment fictitious invoices totalling approximately $44,000. He had then obtained payment by exerting "undue influence" over his subordinate staff to circumvent the Hospital's established payment processing controls. The employee was charged with theft and convicted. Arrangements have been made for restitution of the misappropriated money.

This misappropriation of funds demonstrates that although an effective system of internal control reduces the probability of fraud and error, it does not eliminate the possibility that they might occur. A major inherent limitation is the possibility of management overriding an otherwise effective control.

Given that established internal control procedures are satisfactory, the Auditor General in a management letter to the Executive Director at the conclusion of the audit recommended that Hospital personnel be instructed to adhere to established control procedures, and to bring to the attention of the Executive Director any instance where a direction has been given by senior management to circumvent recognized control procedures.

2.16.9 **Foothills Provincial General Hospital** — year ended March 31, 1986

The annual financial audit was extended to include an examination of the system and procedures used by the Hospital to claim revenue for outpatient visits.

Observations from Extended Audit Work

The Hospital was a participant in a three year pilot operating funding project with the Department of Hospitals and Medical Care. As part of this project, the Hospital received approximately $60 for each recorded outpatient visit. It was important, therefore, that all outpatient visits were properly recorded and reported. Because each outpatient department is responsible for maintaining its own records, the examination included a review of controls in place at the major outpatient departments. The following observations arose during the review:

— All hospital departments examined used a source form which was prepared for each outpatient visit. However, since the forms were not prenumbered, it was impossible to determine whether or not all forms had been recorded.

— Errors were observed in the compilation of total outpatient visits. These errors were brought to the attention of Management and adjusted.

In the management letter to the Hospital's President at the conclusion of the audit, the Auditor General recommended that, if funding of outpatient costs continues to be determined on the basis of visits, controls be strengthened in all outpatient departments to ensure that all visits are recorded and summarized correctly.

The pilot funding project ended at March 31, 1986 and the level of funding provided to the Hospital is no longer dependent on the accuracy of outpatient visit information. The Hospital has indicated, however, that action has been taken to improve control over outpatient services.

Follow-up of Previous Annual Report Recommendations

In his 1984-85 annual report (section 3.5.6), the Auditor General reported that the balance sheet of the Foothills Provincial General Hospital as at March 31, 1985 included accounts receivable for disputed claims for geographic appointments funding from the Department of Hospitals and Medical Care totalling approximately $2,300,000. These claims pertained to the 1982-83, 1983-84 and 1984-85 fiscal years. Because of the uncertainty as to collection, and the significance of the amounts involved, the Auditor General included a reservation of opinion in his report on the financial statements of the Hospital for the year ended March 31, 1985. He also recommended that the Hospital and the Department resolve the dispute.

The Hospital and the Department have now resolved the dispute over geographic appointments funding. The Department paid the Hospital almost $1,000,000 and the Hospital treated its loss of approximately $1,300,000 as a prior period adjustment in the financial statements for the year ended March 31, 1986.

2.16.10 **University Hospitals Board** — year ended March 31, 1986

Observations from Financial Audit Work

During 1985-86, a computer programming error and control weaknesses in the Board's revenue systems resulted in revenue not being billed and recorded. The main concerns revealed by the 1985-86 audit were as follows:

— Physiotherapy and occupational therapy revenue totalling approximately $170,000 had not been billed or recorded. A change to a computer program used to generate billings, which was not adequately tested, together with a breakdown in communication between certain hospital departments, resulted in the programming error not being detected by the staff. This matter was brought to the attention of Management and the revenue was subsequently invoiced.

— Outpatient registrations in the emergency department are recorded on a computer system which identifies billable patients. Despite this facility, billing is determined by sorting treatment cards manually. On a number of occasions amounts were not billed, even though the computer system indicated that they were billable. It is estimated that foregone revenue resulting from unbilled amounts could be approximately $60,000 per year.

— Patients for whom charges are billable to The Workers' Compensation Board are not always being identified as such at the time of admission. This situation results in a loss of revenues.

During the past few years the Audit Office has expressed various concerns regarding the lack of controls to ensure that all revenues are correctly accounted for by the Hospitals Board. The errors noted above raise concerns about the possibility of other errors that have not been detected through selective audit testing for inpatient, outpatient and special purpose fund revenues.

In the management letter to the Board's President at the conclusion of the audit, the Auditor General made the following recommendation:

Recommendation No. 32

It is recommended that the University Hospitals Board take steps to ensure that:

— *adequate procedures are followed when making changes to computer programs so that there is proper testing of changes and co-ordination with user departments,*

— *the computer system is enhanced to generate billings for emergency outpatients,*

— *procedures during the admitting stage are strengthened to highlight injuries that could result in billings to The Workers' Compensation Board, and*

— *an in-depth investigation is conducted, by the Board's internal audit department, of the revenue systems for patient charges and special purpose funds to highlight weaknesses that should be addressed to ensure that all revenues are recorded and received.*

2.16.11 **Alberta Cancer Foundation** — year ended March 31, 1986

Observations from Financial Audit Work

The Auditor General's report on the financial statements of the Foundation for the year ended March 31, 1986, contained a reservation of opinion because, as explained in section 3.2.2, of this report, the Foundation receives donation revenue which was not susceptible of complete audit verification.

2.16.12 Financial audits of the following were also completed:

Edmonton Area Hospital Advisory Council Fund - year ended June 30, 1985
Edmonton Area Hospital Advisory Council Fund - period ended March 31, 1986
Glenrose Rehabilitation Hospital - year ended March 31, 1986
University Hospitals Foundation - year ended March 31, 1986

2.17 HOUSING

Of the matters reported to management, the observations and recommendation below are those which the Auditor General considers should be brought to the attention of the Legislative Assembly.

2.17.1 **Department of Housing** — year ended March 31, 1986

The annual financial audit was extended to include an examination of the budgeting process to assess the adequacy and appropriateness of the systems that support the submission of annual budgets and assist in controlling expenditures.

Observations from Extended Audit Work

The examination of the budgeting process revealed that generally the systems and procedures used were adequate, and that the methodology used by the Planning Secretariat when implementing new programs was particularly appropriate. The examination also indicated, however, that submissions of budget information to the Budget Bureau were not adequately supported by formal documentation as required by the Budget Bureau Manual, thereby prolonging the review procedure. In addition, the month-by-month monitoring of actual expenditures against budgets was of limited value because the monthly budget figures used were one twelfth of the annual budget rather than being anticipated monthly expenditures.

In the management letter to the Deputy Minister at the conclusion of the audit, the Auditor General recommended that the Department improve the formal documentation supporting its budget submissions to the Budget Bureau, and enhance its budget detail to facilitate the effective monitoring of monthly expenditures.

The Department has since indicated that, in future, the financial planning officer will require program staff to document their assumptions and rationale in support of budget requests for their inclusion in the budget package.

2.17.2 **Alberta Mortgage and Housing Corporation** — year ended March 31, 1986

The annual financial audit was extended to include a review of the impact of the general decline in land and property values during the past several years in Alberta, on the Corporation's accounting policies and reporting practices.

Observations from Extended Audit Work

The Corporation does not account for and report its land programs in accordance with generally accepted accounting principles (GAAP). At present, the Corporation's published operating results do not differ materially from the results that would be reported if GAAP were applied. In future years, however, it is possible that applying GAAP could produce significantly different operating results than would be produced using the Corporation's present accounting and reporting practices.

The Audit Office's review of the impact of the general decline in property values focussed particularly on the Corporation's investments in land programs.

The Corporation has two classes of investment in land programs; one is land held for sale, and the other is land banking and inventory. Land held for sale is land which the Corporation is actively marketing and wishes to dispose of in the short-term. Land banking and inventory is land which the Corporation intends holding for a number of years.

With effect at March 31, 1986, the Corporation changed its accounting policy for valuing land banking and inventory by establishing provisions to allow for declines in value considered to be of an enduring nature. Following this change, land held for sale and land banking and inventory were all valued at cost less an allowance for declines in value considered to be of an enduring nature.

At March 31, 1986, of the $237 million provided by the Corporation for potential losses on its land and real estate investments (cost price $645 million), $100 million was for enduring declines in the value of its land programs.

The value ascribed to the total investment in land programs on the Corporation's March 31, 1986 balance sheet is not materially different to what it would be if generally accepted accounting principles (GAAP) were used. GAAP requires that short-term investments (ie. land held for sale) be valued at the lower of cost or market value. GAAP also requires that long- term investments (ie. land banking and inventory) be valued at cost, except to the extent that a non-temporary decline in value has occurred. When this happens, the investment should be written down permanently, rather than establishing a provision.

The Corporation's present accounting policy is a departure from GAAP, in that enduring losses on land banking and inventory are provided for but are not written off, and land held for sale is not valued at the lower of cost or market, but rather losses of an enduring nature are provided for. These departures do not at present, however, affect significantly the determination of the Corporation's annual deficit or the valuation of its investments. Nevertheless, in years to come with perhaps a changed economic environment, the operating results reported using the Corporation's current policies could differ significantly from the results that would be reported using GAAP.

Since GAAP requires short and long-term investments to be valued on different bases, it is important that the Corporation differentiates clearly between the two to ensure that all land investments are classified correctly. It was observed during the audit that some land appeared to be classified incorrectly in the Corporation's records.

In the management letter to the Corporation's President at the conclusion of the 1985-86 audit, the Auditor General made the following recommendation:

Recommendation No. 33

It is recommended that the Alberta Mortgage and Housing Corporation:

- *adopt an accounting policy of valuing land held for current sale at the lower of cost or market value at the balance sheet date and that consideration be given to writing off losses of an enduring nature that occur on land included in land banking and inventory, and*

- *review its investment in land programs to ensure that each investment is accurately classified, either as land held for sale or as land banking and inventory.*

2.18 LABOUR

Of the matters reported to management, there were no observations which the Auditor General considers should be brought to the attention of the Legislative Assembly.

2.18.1 **Department of Labour** — year ended March 31, 1986

The annual financial audit was extended to include an examination of the systems and procedures used by the Department to allocate, budget and control inspection costs for the Boilers Branch.

2.19 MANPOWER

Of the matters reported to management, the observations and recommendation below are those which the Auditor General considers should be brought to the attention of the Legislative Assembly.

2.19.1 **Department of Manpower** — year ended March 31, 1986

The annual financial audit was extended to include an examination of the systems and procedures used by the Department (now called the Department of Career Development and Employment) to promote and monitor compliance with the legislation and policies governing the Priority Employment Program and the Summer Temporary Employment Program.

Follow-up of Previous Annual Report Recommendations

In his 1983-84 and 1984-85 (section 3.5.4) annual reports, following observed inaccuracies in the Department's accounts payable in the 1983-84 and 1984-85 public accounts, the Auditor General recommended that the Department improve the accuracy of its financial reporting in this area.

The 1985-86 annual audit revealed that accounts payable at March 31, 1986 and, therefore, expenditures for the fiscal year then ended, were both overstated by approximately $3 million. The payables in question were for costs related to Special Employment Program contracts that were planned but subsequently cancelled or otherwise not fulfilled. The Audit Office acknowledges that, due to the nature of this Program, accurate information relating to the status of commitments is often unavailable at fiscal year-ends. It also acknowledges that the Department took positive action during 1985-86 to improve this situation by significantly improving claim processing procedures. Nevertheless, it is believed that scope still exists for further improvements to internal communications and systems which would result in the production of more accurate financial information for inclusion in the public accounts.

In the management letter at the conclusion of the 1985-86 audit, the Auditor General again made the following recommendation:

Recommendation No. 34

It is recommended that the Department of Career Development and Employment ensure that the annual expenditures and accounts payable relating to its Special Employment Program activities are reported accurately in the public accounts of the Province.

2.20 MUNICIPAL AFFAIRS

Of the matters reported to management, the observations and recommendation below are those which the Auditor General considers should be brought to the attention of the Legislative Assembly.

2.20.1 **Department of Municipal Affairs** — year ended March 31, 1986

The annual financial audit was extended to include an examination of the systems and procedures used by the Department to budget, administer and account for unconditional grants to municipalities.

Follow-up of Previous Annual Report Recommendations

The 1984-85 audit included a review of the Department's 1983-84 annual report which was tabled in the Legislative Assembly during 1984-85. In his 1984-85 annual report (section 3.5.5), the Auditor General commented on differences between the financial information relating to the Special Areas Trust Account contained in the Department's 1983-84 annual report, and the information contained in the Trust Account's audited financial statements. He recommended that in future the Department ensure that the financial information contained in tabled annual reports is accurate, complete and consistent with the information published in the Province's public accounts.

A review of the Department's 1984-85 annual report during the 1985-86 audit revealed that the audited financial statements of the Trust Account are reproduced therein in their entirety and the Department has indicated that it will continue this practice in future.

2.20.2 **Metis Population Betterment Trust Account** — year ended March 31, 1986

Follow-up of Previous Annual Report Recommendations

Various previously reported irregularities pertaining to the establishment and administration of the Metis Population Betterment Trust Account persisted throughout 1985-86.

The Auditor General commented on these irregularities in his 1983-84 and 1984-85 (section 3.7.7) annual reports to the Legislative Assembly. The main problem concerns the legality of the Trust Account. A legal opinion obtained by the Auditor General states that the Trust Account is not legally constituted because section 8 of The Metis Betterment Act lacks the authority to establish a fund of this nature. If the Trust Account is not legally constituted, it follows that the revenue it receives, the expenditures it makes, the assets it acquires, and the liabilities it incurs, all lack legislative authority.

Another problem concerns the manner in which the members are appointed and elected to the local boards of the eight settlement associations established under the Act. The method used does not comply with section 4(3) of the Act. In addition, the legislation governing the payment of honoraria to board members appears to be inconclusive and flawed. These two concerns cast considerable doubt on the legitimacy of honoraria paid to board members by the Department of Municipal Affairs.

In his 1983-84 annual report, the Auditor General recommended that as soon as practical, action be taken to resolve the various problems relating to non-compliance with, and inadequacies in, the Trust Account's legislative authorities. In making this recommendation, however, he acknowledged that some legislative changes may have to await removal of a moratorium on such changes pending resolution of a long-standing legal action against the Province by the eight Metis settlement associations claiming revenue derived from oil and natural gas leases on the Crown lands on which the Metis settlements are situated.

The Province has acknowledged the need to update The Metis Betterment Act and its regulations. Following a report in July 1984 from a committee chaired by Dr. Grant MacEwan, the Government reviewed the nature, form and timing of new legislation and is encouraging more discussion with the Metis people on its content. The Department of Municipal Affairs has recently informed the Audit Office that, although the moratorium on legislative amendments is still in place, it is continuing to develop new legislation in conjunction with the Metis people with a view to introducing a new Act in 1987.

Pending resolution of these concerns, the Auditor General's previous recommendation is repeated:

Recommendation No. 35

It is recommended that, as soon as practicable, action be taken by the Department of Municipal Affairs to resolve the various problems relating to non-compliance with the legislative authorities pertaining to the establishment and administration of the Metis Population Betterment Trust Account.

2.20.3 Financial audits of the following were also completed:

Alberta Planning Fund - year ended March 31, 1986
Improvement Districts' Trust Account - year ended December 31, 1985
Metis Settlement Associations Grants Administration Fund - year ended March 31, 1986
Metis Settlements Trust Fund - year ended March 31, 1986
Special Areas Trust Account - year ended December 31, 1985

2.21 PUBLIC WORKS, SUPPLY AND SERVICES

Of the matters reported to management, there were no observations which the Auditor General considers should be brought to the attention of the Legislative Assembly.

2.21.1 **Department of Public Works, Supply and Services** — year ended March 31, 1986

The annual financial audit was extended to include a review of the procedures used by the Department to monitor compliance with Treasury Board Directive 04/84. This Directive prescribes procedures for the acquisition and development of electronic data processing facilities and systems.

2.21.2 **Public Works, Supply and Services Revolving Fund** — year ended March 31, 1986

The annual financial audit was extended to include an examination of the systems and procedures used by Management to manage the warehouse inventory, and to set charge out rates for the use of the Fund's EDP facilities.

2.21.3 A financial audit of the Public Works, Supply and Services Security Deposits Trust Fund for the year ended March 31, 1986 was also completed.

2.22 RECREATION AND PARKS

Of the matters reported to management, the observations below are those which the Auditor General considers should be brought to the attention of the Legislative Assembly.

2.22.1 **Department of Recreation and Parks** — year ended March 31, 1986

The annual financial audit was extended to include a review of the systems and procedures used by the Department to monitor compliance with legislative authorities governing the Department's grant programs.

Follow-up of Previous Annual Report Recommendations

In his 1984-85 annual report (section 3.3.5), the Auditor General commented on a situation where legislatively approved expenditure limits applicable to grants disbursed for the development of major cultural and recreational facilities were not amended when a change in policy was authorized. He recommended that in future the Department ensure that the necessary legislative amendments are obtained so that the resulting grant disbursements have legislative authority.

The Department concurred with the Auditor General's recommendation. However, the program in respect of which the Auditor General's recommendation was made has now terminated.

2.22.2 **Alberta Sport Council** — year ended March 31, 1986

The annual financial audit was extended to include the following:

— An examination of the system and procedures used by the Council to identify, account for, control and safeguard its fixed assets.

— An examination of the system and procedures used to allocate and account for funding provided to sport associations. This examination focussed on the procedures used by the Council to screen funding requests, to allocate and approve funding, and to monitor the subsequent use of such funding.

Observations from Extended Audit Work

The Council was not exercising its right to determine whether the programs it funds are being administered by sports associations to acceptable and appropriate standards. This concern was also raised during the 1984-85 audit.

In the management letter to the Council's Chairman at the conclusion of the 1985-86 audit, the Auditor General again recommended the Council develop and establish audit and evaluation procedures in respect of the various sports associations' programs funded by the Council. It is understood that such procedures have since been drafted and will be implemented shortly.

Observations from Financial Audit Work

The Auditor General's report on the financial statements of the Council contained a reservation of opinion because, as explained in section 3.2.2 of this report, the Council receives donation revenue which is not susceptible of audit verification.

2.22.3 **The Recreation, Parks and Wildlife Foundation** — year ended March 31, 1986

The annual financial audit was extended to include an examination of the system and procedures used by the Council to monitor and determine whether the organizations to which grants are paid use the funding for the purposes intended.

Observations from Extended Audit Work

The Foundation did not have satisfactory procedures to determine whether, or to what extent, the grants it pays to eligible organizations are used for the purposes intended. This concern was also raised during the 1984-85 audit.

In the management letter to the Chairman of the Foundation at the conclusion of the 1985-86 audit, the Auditor General again recommended that the Foundation commence the performance of program audits and evaluations. The Chairman has since indicated that a program of evaluating and auditing the associations funded by the Foundation has been implemented

Observations from Financial Audit Work

The Auditor General's report on the financial statements of the Foundation contained a reservation of opinion because, as explained in section 3.2.2 of this report, the Foundation receives donation revenue which is not susceptible of audit verification.

2.22.4 Financial audits of the following were also completed:

Recreation and Parks Revolving Fund - year ended March 31, 1986
International Youth Year — 1985 Trust Fund - year ended March 31, 1986

2.23 SOCIAL SERVICES AND COMMUNITY HEALTH

Of the matters reported to management, the observations and recommendations below are those which the Auditor General considers should be brought to the attention of the Legislative Assembly.

2.23.1 **Department of Social Services and Community Health** — year ended March 31, 1986

The annual financial audit was extended to include the following:

— Reviews of the accounting systems and internal controls in place at, and the accountability information provided to the Department by, Claresholm Care Centre, Claresholm; Rosehaven Care Centre, Camrose; and Michener Centre, Red Deer.

— Reviews of the methods used at several of the Department's district offices to process and disburse social allowance payments.

— An examination of the system used by the Department to administer the Alberta Aids to Daily Living and Extended Health Benefits programs. In particular, the examination focussed on the controls in place to ensure that only authorized recipients receive benefits under the programs and that vendors are paid only for authorized services and supplies at approved rates.

— A review of the system and procedures used by the Department to identify and claim costs which are eligible for sharing with the Government of Canada under the Canada Assistance Plan.

In 1986-87, the Social Services part of this Department became the Department of Social Services, and the Community Health part was combined with Occupational Health to become the Department of Community and Occupational Health.

Observations from Extended Audit Work

Alberta Aids to Daily Living/Extended Health Benefits — The 1985-86 annual audit revealed that the system used to administer the Alberta Aids to Daily Living and the Extended Health Benefits programs is generally satisfactory, though some weaknesses were identified. Audit testing indicated that controls are in place to check that all payments under the programs are authorized, that vendors claim only for goods and services authorized, and that no payments are made in excess of the amounts claimed. However, it was concluded that some of the information used to determine the eligibility of beneficiaries under the programs is either inaccurate or incomplete.

The regulations under which the programs operate restrict the eligibility for benefits to Alberta residents holding valid certificates of registration under the Alberta Health Insurance Premiums Act. The audit revealed, however, that most records on the Department's beneficiary master file did not contain AHCIP expiry dates. In addition, numerous payments had been made to beneficiaries whose records showed that their AHCIP coverage had expired, and a few records had no AHCIP numbers. These audit findings do not indicate necessarily that ineligible claimants have received benefits; they do indicate, however, for many of the benefit payments disbursed, the Department was unable to determine whether or not the claimants met the AHCIP eligibility requirement.

In the management letter to the Deputy Minister at the conclusion of the audit, the Auditor General made the following recommendation:

Recommendation No. 36

It is recommended that the Department of Community and Occupational Health maintain accurate, complete and up-to-date information which can be used to determine the eligibility of beneficiaries under the Alberta Aids to Daily Living Program and the Extended Health Benefits Program.

Canada Assistance Plan — Under the Canada Assistance Plan Agreement, the Canada Department of Health and Welfare contributes towards the costs of certain programs administered and provided by the Province of Alberta. During 1985-86, most of these programs were administered by the Department of Social Services and Community Health. Much of the information used by the Department to support claims for contributions from the Government of Canada is obtained from "nominal rolls". These are reports submitted to the Department by the various institutions approved under the Agreement which provide details, inter alia, of eligible expenditures.

The review of the system and procedures used by the Department to identify and claim expenditures which are eligible for cost-sharing under the Agreement revealed that:

— nominal rolls are not submitted to the Department in a standard format which facilitates verification and processing,

— the accuracy and completeness of the information contained in nominal rolls is not certified by a senior official of the institutions that submit them, and

— the Department does not have adequate procedures for checking that all applicable nominal rolls are received and processed by its Revenue Administration Section.

The sample of transactions examined by the Audit Office disclosed calculation errors and processing omissions which had resulted in the Department claiming $27,000 less than it should have done under the Canada Assistance Plan Agreement.

The review also revealed that the Department lacks procedures for regularly and systematically following up and dealing with expenditures which are temporarily not claimable under the Agreement.

From time to time, the Department and various institutions incur expenditures which are potentially eligible for cost-sharing under the Agreement, but which cannot be claimed until they are approved by the Government of Canada. Pending such approval, the Department charges these expenditures to "holding codes". Expenditures in excess of $30 million incurred during 1985-86 were still held in holding codes several months after the end of the fiscal year. Of this amount, almost $18.2 million represented expenditures under the Widows' Pension Plan which has not been approved for sharing, and almost $12.3 million represented expenditures incurred by institutions which have not been approved by the Government of Canada.

In a management letter to the Deputy Minister at the conclusion of the audit, the Auditor General made the following recommendation:

Recommendation No. 37

It is recommended that the Department of Social Services take steps to improve the system for identifying, tracking and claiming costs sharable with the Government of Canada under the Canada Assistance Plan.

Observations from Financial Audit Work

Year-end accounts payable — The Department did not record as accounts payable at March 31, 1985, certain expenditures under the Alberta Aids to Daily Living and Extended Health Benefits

Programs incurred but not paid during the year. This practice was queried during the 1984-85 audit and the Department stated that the amount involved did not warrant the effort of quantifying it. The Department also indicated that it would be approaching the Treasury Department to seek an exemption from the need to record these liabilities.

At March 31, 1986, the Department recorded accounts payable totalling approximately $1 million to cover outstanding expenditures under the aforementioned programs. Since this was inconsistent with the practice and explanations provided relating to March 31, 1985, the matter was again queried during the 1985-86 audit. The explanation given by program staff was that the liabilities were set up because unexpended funds were available in the 1985-86 budget.

In view of the inconsistent financial reporting that had occurred, and because the explanations provided by the Department had been similarly inconsistent, the Auditor General made the following recommendation in a management letter to the Deputy Minister:

Recommendation No. 38

It is recommended that the Department of Community and Occupational Health adopt a consistent accounting treatment for establishing liabilities at year-ends for expenditures under the Alberta Aids to Daily Living and Extended Health Benefits Programs.

Follow-up of Previous Annual Report Recommendations

Provincial Laboratory of Public Health — During the Department's 1983-84 annual audit, it was observed that the legislative status of the Provincial Laboratory of Public Health was somewhat unusual. The Laboratory and its objectives were originally established by an Order in Council in 1907. Today, the Laboratory operates with very different objectives and in a similar manner to a Provincial agency. However, the Laboratory does not operate under the authority of a Provincial statute.

In his 1983-84 and 1984-85 (section 3.4.6) annual reports, the Auditor General recommended that the Department proceed with efforts to resolve the uncertainties concerning the operations and legislative status of the Laboratory.

During the 1984-85 annual audit, the Department indicated that appropriate changes would be made in July 1986 provided that the necessary legislative changes could be effected during the 1986 spring session of the Legislature. The necessary legislation was not passed, however, and the Laboratory's status remains unchanged. Accordingly, in the management letter to the Deputy Minister at the conclusion of the 1985-86 audit, the Auditor General again made the following recommendation:

Recommendation No. 39

It is recommended that the Department of Community and Occupational Health continue with efforts to resolve the uncertainties concerning the operations and legislative status of the Provincial Laboratory of Public Health.

Child Welfare payment and information system — The Department's 1983-84 annual audit identified a number of weaknesses in the system used to administer certain aspects of the Department's Child Welfare Program. In his 1983-84 annual report, the Auditor General recommended that the system be strengthened to ensure that:

(a) it meets the Department's information needs, including providing explanations for variances between budgeted and actual costs,

(b) caseworkers, administrative staff and case files comply with the requirements of the Department's Child Welfare Program Manual, and

(c) payments for goods and services supplied are properly authorized, documented and not duplicated.

The 1984-85 annual audit revealed that the Department had strengthened its procedures for ensuring that payments for goods and services supplied are properly authorized, documented and not duplicated. Furthermore, no irregular expenditures of this nature were revealed by the 1984-85 or 1985-86 annual audits. Accordingly, although the Auditor General repeated the recommendation in his 1984-85 annual report, part (c) thereof was not repeated.

In response to the 1984-85 recommendation, the Provincial Treasurer stated in a report to the Public Accounts Committee:

> "The Child Welfare Information System is continually being enhanced to serve as an effective management tool in delivery of child welfare services and meeting departmental responsibilities under the Child Welfare Act.
>
> Child care workers have been reminded to comply with the Child Welfare Program Manual. A unit has been established to monitor compliance with policy and procedures."

During the 1985-86 annual audit, the Audit Office began a complete review of the action taken and being taken by the Department to address the previously reported concerns. Pending completion of that review during the 1986-87 annual audit, the Auditor General's management letter to the Deputy Minister at the conclusion of the 1985-86 audit again contained the following recommendation:

Recommendation No. 40

It is recommended that the Department of Social Services continue to improve the Child Welfare payment and information system to ensure that:

— *it meets the Department's information needs, including providing explanations for variances between budgeted and actual costs, and*

— *caseworkers and administration staff comply with the requirements of the Department's Child Welfare Program Manual.*

Children in Care — The 1984-85 annual audit identified a number of weaknesses in the procedures used by the Department for ensuring that operators of residential facilities for children in care comply with their funding and other financial obligations. One instance was observed where an operator had submitted budgets and claims for funding which contained numerous and substantial expenses which were ineligible under the terms of the funding agreement. In addition, the operator had been exempted from the contractual requirement to provide audited financial statements and had not refunded to the Department certain operating surpluses.

In his 1984-85 annual report the Auditor General recommended that the Department establish procedures for monitoring compliance by operators of residential facilities for children in care with their budgeting, reporting, refunding and other financial obligations under the agreements pursuant to which they receive Provincial funding.

In response to this recommendation, the Provincial Treasurer stated in a report to the Public Accounts Committee:

> "The Department has initiated a new negotiating strategy, together with standard financial statement formats for budgeting and reporting. This process will facilitate improved monitoring of financial activities."

These new procedures were not in effect during the 1985-86 fiscal year. Their implementation and effectiveness in eliminating the previously reported concerns will be reviewed during future audits and, accordingly, the Auditor General's management letter to the Deputy Minister at the conclusion of the audit contained the following recommendation:

Recommendation No. 41

It is recommended that the Department of Social Services continue to improve its procedures for determining whether the expenditures reported by operators of residential facilities for children in care are accurate and eligible under the funding contracts, and for ensuring that surplus funding is recovered by the Department.

Income Security Program systems — The 1984-85 annual audit identified deficiencies in the five separate computer systems that capture and record payments under the Department's Income Security Program, and which assist in verifying the eligibility and entitlements of income security recipients. It was observed that some transfers of data between these systems were not performed automatically, and the Department did not have adequate procedures for ensuring the consistency of data on the computer files of the various systems. Auditing techniques used to analyse various systems files revealed instances where the data contained anomalies and inconsistencies.

In his 1984-85 annual report the Auditor General recommended that procedures be established to detect and correct anomalies and inconsistencies in the data stored on the computer systems used to administer the Income Security Program. He also suggested that consideration be given to integrating the systems so that inconsistent information and unusual transactions could be detected and investigated.

In response to this recommendation, the Provincial Treasurer stated in a report to the Public Accounts Committee:

> "The Department is in the process of improving the Income Security System. Several initiatives are under way to enhance intake procedures, to integrate various systems and to ensure appropriate reports are provided to managers to facilitate meaningful reviews of social allowance expenditures."

The effects of these improvements and initiatives were not evident during the 1985-86 annual audit. Accordingly, in the management letter to the Deputy Minister at the conclusion of the audit, the Auditor General again made the following recommendation:

Recommendation No. 42

It is recommended that the Department of Social Services establish procedures to detect and correct anomalies and inconsistencies in the data stored on the various computer systems used to administer the Income Security Program. Consideration should be given to integrating the systems used to capture and record data so that unusual transactions and errors are highlighted for investigation.

Alberta Dental Association — During the Department's 1983-84 annual audit, deficiencies were observed in the contract arrangements between the Department and the Alberta Dental Association (A.D.A.), as well as in the procedures used by the Department to administer the contract. In his 1983-84 annual report, and again in his 1984-85 annual report, the Auditor General recommended that the Department improve its procedures for ensuring that it pays the A.D.A. only for services that are valid, eligible and reasonable. He also suggested that future contracts of this nature be more precise in defining administrative costs that are eligible for reimbursement.

In a response to the 1984-85 recommendation, the Provincial Treasurer stated in a report to the Public Accounts Committee:

"The Department is assessing how specific dental services provided can be identified within the existing information system. In the meantime, the current agreement identifies the services to be provided. Administrative services provided are identified and are reimbursed monthly at $2.10 per claim processed. In addition, the current agreement provides for an auditor's report on compliance which will provide assurance that services paid for are valid, eligible and reasonable."

In August 1986, the Department entered into a new agreement with the A.D.A., the terms of which address the Auditor General's previously reported concerns.

Vocational Rehabilitation of Disabled Persons — In his 1983-84 annual report, the Auditor General described deficiencies in the Department's system for providing vocational rehabilitation for disabled adults. Adequate procedures were not in place to ensure that grants were calculated and disbursed in accordance with approved criteria, or for determining whether funded agencies were operating as contemplated in legislation.

The Auditor General recommended in his 1983-84 annual report, and again in his 1984-85 annual report, that the Department issue standards and guidelines governing the preparation of budgets and financial reports by vocational training and rehabilitation agencies. He also recommended that the Department develop systems for monitoring compliance by these agencies with these standards and guidelines, and for ensuring that grants are disbursed only in accordance with established criteria.

In a response to the 1984-85 recommendation, the Provincial Treasurer stated in a report to the Public Accounts Committee:

"The Department has finalized guidelines for standardized budget submission and financial reporting formats for the 1986-87 fiscal year to cover rehabilitation agencies. These guidelines and formats will be developed and applied to vocational day training agencies in the 1987-88 fiscal year."

During the 1985-86 annual audit, it was observed that the Department is finalizing the development of procedures to contract for required services and for standardizing report formats. These procedures are designed to provide direction to regional offices for monitoring the activities of agencies.

2.23.2 Financial audits of the following were also completed:

Alberta Alcohol and Drug Abuse Commission
Child Welfare Family Allowance Trust
Child Welfare Trust
Various Institutions Trust Accounts

All of these were audited for the fiscal year ended March 31, 1986.

2.24 SOLICITOR GENERAL

Of the matters reported to management, the observations and recommendation below are those which the Auditor General considers should be brought to the attention of the Legislative Assembly.

2.24.1 **Department of the Solicitor General** — year ended March 31, 1986

The annual financial audit was extended to include the following:

— A review of the system and procedures used by the Department to monitor and identify expenditures under the Young Offenders' Program that are eligible for cost sharing under the agreement with the Government of Canada, and the methods of accounting for cost reimbursement.

— An examination of the internal financial controls in the systems relating to the administration of community correctional services.

— An examination of the methods used to disburse and account for payments under the Provincial Policing Agreement with the Government of Canada.

— An examination of the financial controls and the methods used to account for revenues arising from issuing firearm licences.

— An examination of the financial controls and reporting practices in place at the Lethbridge Correctional Centre and the Calgary Correctional Centre.

Follow-up of Previous Annual Report Recommendations

In his 1984-85 annual report (section 3.4.7), the Auditor General commented on numerous problems that were experienced during the development and implementation of a major new computer system for the Department's Motor Vehicles Division. Most of these problems appeared to have resulted from the Department's senior financial management failing to provide appropriate direction and control. The Auditor General described in detail the problems that had arisen, and made eight specific recommendations designed to address the observed problems or prevent them recurring.

The system in question was the new Motor Vehicles Computer System, dubbed MOVES. The main functions of MOVES are to record information relating to motor vehicle and operator licences, to calculate licence fees, to maintain and control licence inventories, and to produce financial reports of revenues and receivables. MOVES was designed to be a state-of-the-art online system to service these needs throughout the Province. It took three years to develop and cost more than twelve million dollars.

The Auditor General's concluding recommendation in his 1984-85 annual report was that the Department should ensure that suitably trained and experienced personnel are assigned to addressing the numerous accounting and financial control deficiencies identified during the 1984-85 audit, and to preventing their recurrence.

In a report to the Public Accounts Committee, the Department responded to this recommendation through the Provincial Treasurer as follows:

> "The appointment of a new Manager of Financial Administration for the Motor Vehicles Division and the secondment of three accountants from the Finance and Administration Division to specific tasks has enabled urgent attention to be given to most of the deficiencies identified. Top priority has also been given to specific related tasks undertaken by the

Systems and Information Services Division, and this will be ongoing for some time. The newly appointed Chief Internal Auditor as well as a Coordinator of Financial Systems Development will provide added confidence that accounting and financial control deficiencies are prevented in the future."

The 1985-86 audit revealed that the Department has indeed made a concerted effort to address the Auditor General's previously reported concerns. The previously reported systems deficiencies have largely been remedied as a result of actions taken, and the few remaining minor problems stemming from the implementation of MOVES are being actively addressed by the Department.

In a management letter to the Deputy Minister at the conclusion of the 1985-86 annual audit, the Auditor General commended the Department on the speed and effectiveness of the action taken in response to his 1984-85 recommendations.

Observations from Financial Audit Work

Prior to the implementation of MOVES in September 1984, inventories of licences and other unused forms were recorded and controlled using a manually maintained stock ledger. A program of periodic counts checked that inventories on hand were recorded accurately. When MOVES was implemented, the manual stock ledger was discontinued on the understanding that the new system would record, control and monitor the use of all licences and forms acquired and issued by the system. Unfortunately, it did not do so.

The 1985-86 annual audit revealed numerous problems in connection with inadequately performed inventory counts and inaccurate inventory staging reports produced by MOVES. Due mainly to inadequate staff training and instructional material, inventory received by the Division's Distribution Centre and shipped to regional offices or destroyed or damaged, was not accurately recorded on MOVES. As a result, the staging and inventory summary reports produced by MOVES were inaccurate and unreliable. Furthermore, year-end inventory counts were not performed satisfactorily. This was mainly because regional offices were not provided with documented count instructions governing how to perform the counts, the direction of counting, and what to do about discrepancies between inventory on hand and the inventory records.

Pending resolution of these problems, the Department re-instituted the manual stock ledger and related count procedures as at April 1, 1986.

In the management letter to the Deputy Minister at the conclusion of the 1985-86 audit, the Auditor General made the following recommendation:

Recommendation No. 43

It is recommended that, in connection with the Motor Vehicles Division, the Department of the Solicitor General take immediate steps:

— *to improve inventory control procedures associated with licences and to establish procedures at regional offices governing periodic inventory counts, and*

— *to investigate and resolve existing discrepancies between the counts and inventory records.*

2.24.2 Financial audits of the following were also completed:

Motor Vehicle Accident Claims Fund - year ended March 31, 1986
Alberta Racing Commission - year ended March 31, 1986
Alberta Liquor Control Board - period ended January 7, 1986
Correctional Institutions Trust Accounts - year ended March 31, 1986

2.25 TECHNOLOGY, RESEARCH AND TELECOMMUNICATIONS

Of the matters reported to management, the observations and recommendations below are those which the Auditor General considers should be brought to the attention of the Legislative Assembly.

2.25.1 **Alberta Research Council** — year ended March 31, 1986

Observations from Financial Audit Work

The 1985-86 audit revealed that by acquiring an investment in a partnership, the Council has exceeded its authority under the Alberta Research Council Act.

The partnership is governed by a limited partnership agreement under which each limited partner (there is one general and nine limited partners) agree to advance $300,000 to the partnership over a three year period. At March 31, 1986, the Council had advanced $100,000 to the partnership. The partnership was formed to invest in equity securities of Alberta enterprises which are at the conceptual, research and development or prototype stages of product development.

Section 4 of the Alberta Research Council Act prescribes the powers and duties of the Alberta Research Council as follows:

"4(1) The Alberta Research Council may conduct, on a scientific or engineering basis,

(a) research related to the utilization and upgrading of the natural resources of Alberta;

(b) research on new and improved technical processes and methods that are or might be used in Alberta industries;

(c) research on behalf or pursuant to agreements with persons, firms or organizations that wish to avail themselves of the expertise and facilities of the Alberta Research Council;

(d) basic and applied research in the natural sciences with the objective of improving the welfare and progress of urban and rural life in Alberta;

(e) research to ensure the effective application of technology developed by the Alberta Research Council in both the public and private sectors of Alberta.

(2) The Alberta Research Council

(a) shall, at the request of the Executive Council, advise it on questions of scientific and technological methods affecting the expansion of industries or the utilization of the natural resources of Alberta, and

(b) shall supervise matters affecting scientific and industrial research assigned to it by the Lieutenant Governor in Council."

This section of the Act appears to limit the Council's activities to conducting research, advising the Executive Council, and such other activities as are authorized by the Lieutenant Governor in Council. In order to conduct research, the Council presumably has to control the research activities. Since the Council does not control the limited partnership, or the activities of entities receiving capital from the limited partnership, the investment by the Council in the limited partnership is ultra vires the powers provided by section 4 of the Act.

In a management letter to the Council's President at the conclusion of the 1985-86 audit, the Auditor General commented on the importance of the Council adhering to the requirements of its governing legislation and made the following recommendation:

Recommendation No. 44

It is recommended that the Alberta Research Council consider divesting itself of its investment in the partnership formed to acquire equity securities in certain Alberta enterprises or, alternatively, seek amendments to the Alberta Research Council Act to authorize the investment and allow the Council to become involved in similar activities in future.

Follow-up of Previous Annual Report Recommendations

The previously reported deficiencies in the Council's financial systems and accounting records persisted throughout 1985-86.

In his 1984-85 annual report (section 3.4.2), the Auditor General acknowledged the progress made by the Council in eliminating many of the deficiencies first reported to the Legislative Assembly following the 1979-80 annual audit. He recommended, however, that the Council continue with its efforts to eliminate the remaining financial control problems in its fixed asset, project contracts and inventories systems.

The 1985-86 annual audit revealed that the previously reported concerns remained unresolved as follows:

— Uncertainties continued regarding the ownership of certain fixed assets that are recorded on the Council's balance sheet.

The contracts under which some research projects are carried out allow the Council to receive title to any fixed assets acquired during the projects. Under some contracts, title to such assets passes to the Council automatically on completion of the project. Under others, the passing of title is at the discretion of the project sponsor. The Council's balance sheet does not indicate, and its records cannot identify, which of the fixed assets recorded thereon belong to the Council and which belong to project sponsors.

It was for this reason that the Auditor General issued a reservation of opinion in his report on the Council's March 31, 1986 financial statements. In that report he stated that he had been unable to determine whether any adjustment may be required to fixed assets and fixed assets equity on the Council's balance sheet to reflect ownership of fixed assets, because the Council had not identified those fixed assets to which it may not have title.

This was the seventh consecutive year that the Auditor General had issued a reservation of opinion in his report on the Council's financial statements.

During the 1984-85 annual audit, the Council indicated that uncertainties regarding the ownership of its fixed assets would likely be eliminated during the following two or three years. This would be done by renegotiating the contracts which had created the uncertainties. It now appears, however, that this is unlikely to happen because difficulties are being experienced in obtaining title to the assets when the contracts are renegotiated.

It is important for the Council to recognize that there is no easy solution to this problem. The longer it is allowed to persist, the more difficult it will be to resolve. It was first reported to the Legislative Assembly in the Auditor General's 1979-80 annual report when the Council's recorded fixed assets amounted to $9.2 million. At March 31, 1986, the Council's recorded fixed assets amounted to $37.0 million. If the uncertainties regarding ownership of fixed assets are to be resolved within a reasonable time frame, the Council must develop and implement an effective plan of action without delay.

— Control over the custody and use of materials and supplies inventories continued to be inadequate.

The Auditor General first reported this concern to the Legislative Assembly in his 1980-81 annual report. The Council has responded on a number of occasions that the matter will be reviewed to determine the cost-effectiveness of a system to control these inventories properly. The 1985-86 audit revealed, however, that such a review has not been undertaken. It appears that although the Council spends approximately $3 million annually on materials and supplies, it continues to attach a low priority to control in this area.

— The Council continued to enter into project contracts which are silent on the amount and types of costs which can be charged to them, thereby rendering adequate financial control difficult to achieve.

This is a long-standing problem. The Council contends that it is caused, in part, by sponsors wishing to use their own contracts. Often these contracts do not conform to the Council's contract standards and, once they have gone through the sponsor's approval process, are difficult to change.

These situations underline the need for the Council to clarify its contract requirements during initial discussions with sponsors so that contracts can be drafted which facilitate proper financial control over projects.

In a management letter to the Council's President at the conclusion of the 1985-86 audit, the Auditor General again made the following recommendation:

Recommendation No. 45

It is recommended that the Alberta Research Council:

— *develop and implement immediately procedures which will facilitate the identification of fixed assets held but not owned by the Council,*

— *be as specific as possible concerning the amount and types of costs which are chargeable to projects in research contracts, and*

— *establish a system to control, in a cost effective manner, the custody and use of materials and supplies.*

2.25.2 **The Alberta Government Telephones Commission** — year ended December 31, 1985

The audit of the Commission included the audit of the Commission's wholly-owned subsidiaries.

Observations from Financial Audit Work

The Commission's financial statements for the year ended December 31, 1985 report that adjustments reducing the recorded cost of buildings and equipment and accumulated depreciation by $42,274,000 were processed in 1985. The adjustments resulted from the implementation of ongoing control procedures for the reconciliation of station equipment asset records with engineering and billing records.

The magnitude of the reconciliation adjustments is in part due to the length of time since such a reconciliation was previously performed. Although the adjustments had no effect on the value of reported net assets and income of the Commission, the Auditor General is concerned that several significant variances were not investigated adequately before the adjustments were processed. It is Management's opinion that, in general, the investigation of variances by category was taken as far as practical.

Management has informed the Audit Office that the reconciliation of station equipment is to be prepared annually in future and that investigations of variances will provide more specific identification and resolution of any control weaknesses.

2.25.3 Financial audits of the following were also completed:

Department of Technology, Research and Telecommunications - year ended March 31, 1986
Alberta Heritage Foundation for Medical Research - year ended March 31, 1986
The Alberta Educational Communications Corporation - year ended March 31, 1986
The Alberta Government Telephones Employees' Group Life Insurance Trust Account - year ended December 31, 1985
The Alberta Government Telephones Employees' Pension and Death Benefit Fund - year ended December 31, 1985

2.26 TOURISM

2.26.1 Of the matters reported to management, there were no observations which the Auditor General considers should be brought to the attention of the Legislative Assembly with respect to the financial audit of the Department of Tourism for the fiscal year ended March 31, 1986.

2.27 TRANSPORTATION

Of the matters reported to management, the observations and recommendation below are those which the Auditor General considers should be brought to the attention of the Legislative Assembly.

2.27.1 **Department of Transportation** — year ended March 31, 1986

The annual financial audit was extended to include a review of the systems and procedures used by the Department to measure and report on the effectiveness of the Urban Transportation Program.

Follow-up of Previous Annual Report Recommendations

In his 1981-82 annual report, the Auditor General commented on a number of system deficiencies that were observed during the annual audit of the Department (now called the Department of Transportation and Utilities). Successive annual reports since then have acknowledged the progress made towards eliminating these deficiencies. In his 1984-85 annual report the Auditor General identified the one concern that still remained, and recommended that the Department continue with efforts to improve its control over and accounting for fixed assets.

The 1985-86 annual audit revealed that the previously reported deficiencies in the Department's fixed asset control systems had continued. There were still no Departmental guidelines governing the control of fixed assets in the regions, districts and branches, nor were there effective procedures for identifying and dealing with lost, obsolete and surplus assets. However, the Department is formulating plans for the establishment of the necessary control standards and procedures. Consideration is being given to utilizing the same system for its own fixed assets that the Department uses to control and account for the fixed assets of the Transportation Revolving Fund.

In the management letter to the Deputy Minister at the conclusion of the audit, the Auditor General again made the following recommendation:

Recommendation No. 46

It is recommended that the Department of Transportation and Utilities expedite completion of plans to implement its own standards and procedures to control and account for fixed assets of what was formerly the Department of Transportation.

2.27.2 **Transportation Revolving Fund** — year ended March 31, 1986

The annual financial audit was extended to include an examination of the systems and procedures used by Management to safeguard and account for the use of gravel and petroleum inventories.

2.27.3 **Alberta Resources Railway Corporation** — year ended December 31, 1985

The annual financial audit was extended to include a review of certain records of Canadian National Railways (CN), performed by the external auditors of CN who acted as agents of the Auditor General, to assess the accuracy and completeness of the tonnage rentals payable to the Corporation by CN. These rentals are based on the traffic using the railway line built by the Corporation to link Grande Prairie with the main CN line near Hinton, Alberta.

2.28 TREASURY

Of the matters reported to management, the observations and recommendations below are those which the Auditor General considers should be brought to the attention of the Legislative Assembly.

2.28.1 **General Revenue Fund** — year ended March 31, 1986

Section 19(1) of the Financial Administration Act provides that "There shall be one General Revenue Fund to be appropriated to the public service of Alberta into which all public money shall be paid except

(a) money over which the Legislature has no power of appropriation, and

(b) money that is otherwise specially disposed of by this or any other Act."

The financial statements of the General Revenue Fund, together with the Auditor General's report thereon, are published in section 2 of volume I of the Province's 1985-86 public accounts. The same report also covers the detailed information on departmental revenues and expenditures contained in the first twenty-seven sections of volume II.

In effect, the financial statements of the General Revenue Fund report the revenues and expenditures of the twenty-six government departments and the four legislative offices, together with the financial assets and liabilities that they administer.

The approach used in auditing the financial statements recognizes the composite nature of the Fund. Transactions and balances examined for the purpose of reporting on the financial statements were selected using criteria appropriate to the Fund as a whole. The audit included verifying the accuracy of financial reports produced by the departments and the fair presentation of the information they contained into the financial statements of the Fund.

Based on the audit work performed, the Auditor General issued an unqualified report on the financial statements of the General Revenue Fund for the year ended March 31, 1986.

2.28.2 **Treasury Department** — year ended March 31, 1986

The annual financial audit was extended to include the following:

— An examination of the systems and procedures used by the Corporate Tax Administration Division to determine whether all corporate entities operating in Alberta are on the tax roll, and for collecting, depositing and recording tax receivable and received.

— A review of the systems and procedures used to monitor the prompt filing of tobacco tax returns, and to check that tax due to the Province is correctly identified, collected and recorded.

— An examination of the system used to process and disburse funds under the Alberta Farm Fuel Distribution Allowance Program.

— A review of the procedures and methods used by Crown Debt Collections in collecting outstanding debts due to the Province.

Follow-up of Previous Annual Report Recommendations

Pension Administration — In his 1979-80 annual report, the Auditor General commented on a number of deficiencies in the financial controls of the Province's Pension Administration. Suc-

cessive annual reports since then have acknowledged the progressive elimination of those deficiencies. In his 1984-85 annual report (section 3.4.12), the Auditor General reported that two deficiencies remained and recommended continued efforts to eliminate them.

The 1985-86 annual audit revealed that procedures have been established requiring follow-up of computer-produced alert messages and to detect duplicate processing of accounting adjustments. This action effectively eliminates all previously reported system deficiencies.

Tax expenditures — Budgeting and reporting certain program costs as tax expenditures distorts the Province's reported revenues and expenditures and weakens the legislative control that is exercised over these costs.

In his 1984-85 annual report (subsection 3.5.9) the Auditor General recommended that tax expenditures be treated in the same manner as other government expenditures for both budgeting and financial reporting purposes. The current method of budgeting and reporting certain program costs as tax expenditures distorts the Province's reported revenues and expenditures. Furthermore, the control exercised over these costs by the Legislative Assembly is significantly weaker than the control exercised over normal government expenditures.

Tax expenditures are tax revenues foregone as a result of tax law provisions that allow special exemptions or deductions from gross income, or provide special credits, reduced tax rates or tax deferrals. In the case of Alberta, the normal definition of a tax expenditure can be expanded to include those program costs that are deducted from royalty revenue. For example, the Province provides incentives to petroleum and natural gas producers to promote such activities as the drilling of new wells and the use of enhanced oil recovery techniques, by reducing royalty payments for a specified period or to a maximum dollar limit.

Examples of tax expenditures resulting from Provincial legislation are as follows:

	1984-85	1985-86
	(Millions of Dollars)	
Royalty holidays	$ 71.4	$148.8
Incentives for enhanced oil recovery	$215.3	$344.2
Royalty tax credit	$395.9	$410.8
Royalty tax deduction	$112.2	$151.7
Renter's assistance credits	$ 86.2	$ 89.5
Transfer payments pursuant to the Utility Companies Income Tax Rebates Act	$ 65.6	$ 69.0
Small business deductions	$ 50.9	$ 57.9

These significant expenditures are not budgeted as expenditures in the Province's annual budget estimates, nor are they reported as expenditures in the Public Accounts of the Province.

Tax expenditure programs of the Government of Canada can also impact Alberta's tax revenues. Under existing legislation Alberta's income tax revenues are a product of the taxpayer's taxable income, which is defined in Federal legislation. By allowing certain exemptions or deductions from income, the Government of Canada can change taxable income. Accordingly, when the Government of Canada delivers a spending program through the tax system by reducing taxable income, the income tax collected by Alberta is reduced. In effect Alberta shares in the cost of the tax expenditures related to the federal base but has no direct control over or input to the underlying policy decisions.

In his 1984-85 annual report, the Auditor General recommended that the Province treat tax expenditures in the same manner as its other expenditures for both budgeting and financial reporting purposes.

In response to this recommendation, the Provincial Treasurer stated in a report to the Public Accounts Committee:

> "There is no general agreement amongst governments that tax expenditure programs should be provided for in budgetary appropriations and disclosed as expenditure in the financial statements. There is no clear distinction to determine which of these programs are "tax expenditures" and which are truly "revenue abatements". It can also be said that these tax credits and deductions relate to the generation of tax revenue and should, therefore, be applied to reduce this revenue."

In March 1986, the Office of the Auditor General of Canada and the United States General Accounting Office completed a study designed to identify the financial information about federal governments that users need. One of the issues covered in the study was "Would the federal government's Annual Financial Report be more useful if it included information on tax expenditures? If so, for what purpose."

The conclusion reached was that "the usefulness of information on tax expenditures was stressed by almost all users". The study indicated the following:

— Most users wanted Annual Financial Reports to include either a complete listing of tax expenditures or a listing of major tax expenditures with a reference to where further details could be found.

— Some users were of the view that information on tax expenditures should not be included in Annual Financial Reports because their nature was too conjectural.

As indicated in the Auditor General's 1984-85 annual report, the legislative and administrative control exercised over most government revenues is considerably less rigorous than the control exercised over normal expenditures. Revenues, and the tax expenditures deducted from them, do not receive the in-depth budgetary review and debate that normal expenditures receive. In addition, most tax expenditures are disbursed without direct government pre-approval because they are usually deducted by the recipients of the benefits, from revenues paid to the government under self-assessment systems.

For the reasons outlined above, the Auditor General made the following recommendation in the management letter to the Deputy Provincial Treasurer, Management and Control:

Recommendation No. 47

> *It is recommended that the Treasury Department treat tax expenditures in the same manner as normal government expenditures for both budgeting and financial reporting purposes.*

Access to taxation records — The terms of the tax collection agreement between the Governments of Alberta and Canada effectively prevent the Auditor General of Alberta from performing the audit work necessary to report on the collection of Provincial personal income taxes as required by subsection 19(2)(a)(i) of the Auditor General Act. In recent years the Auditor General has obtained a measure of assurance, from audit work performed by the Auditor General of Canada, that the Province receives each year the personal income taxes to which it is entitled. This assurance is obtained by reviewing the work undertaken by the Auditor General of Canada with respect to the audit of the Department of National Revenue — Taxation.

2.28.3 **Alberta Heritage Savings Trust Fund** — year ended March 31, 1986

Follow-up of Previous Annual Report Recommendations

Showing the cumulative amount of the Heritage Fund's non-recoverable "capital" expenditures on its balance sheet as "deemed assets" is potentially misleading.

In his 1984-85 annual report (section 3.5.1), the Auditor General recommended that the cumulative amount of non-recoverable money expended by the Heritage Fund on Capital Projects at March 31, 1985 (the amount referred to as "deemed assets"), be written off to fund equity and no further non-recoverable money expended on Capital Projects after that date be capitalized.

The Provincial Treasurer, in response to this recommendation, stated in a report to the Public Accounts Committee:

> "The capitalization of non-recoverable expenditures from the Capital Projects Division (CPD) of the Heritage Fund and presentation in financial statements as deemed assets represents public policy established by statute. The matter of how CPD investments should be disclosed will be considered by the government in due course and the observations made by the Auditor General will be included in that consideration."

Since this recommendation was made, the deemed assets of the Fund have grown by approximately $240 million and amounted to a cumulative total of $2.4 billion at March 31, 1986. Expressed as a percentage of aggregate net assets and deemed assets, deemed assets grew from 15% to 16% in the year ended March 31, 1986. Despite the disclosure in the financial statements, the potential for misleading the reader of the financial statements as to the Fund's real value exists and continues to grow.

The Auditor General observed in his previous report that the legislation with respect to "deemed assets" commences at section 6(8) of the Alberta Heritage Savings Trust Fund Act with the words: "For the purposes of this section". Thus, in the context of this introduction, the "deeming" of expenditures as assets may be merely for computational purposes in order to establish the limit on Capital Projects Division investments set out earlier in section 6 (see section 6(2)(b)). It may be unnecessary, therefore, to obtain legislative amendments in order to treat non-recoverable money expended as expenditures of the Trust Fund.

Since appropriate action has not been taken, the Auditor General again made the following recommendation in the management letter to the Deputy Provincial Treasurer, Finance and Revenue:

Recommendation No. 48

> *It is recommended that the Provincial Treasurer eliminate from the balance sheet of the Alberta Heritage Savings Trust Fund the cumulative amount of non-recoverable expenditures on capital projects.*

The implementation of this recommendation would not preclude the continuation of the present schedule to the financial statements which shows the cumulative sums spent on each Capital Project. This schedule could even be expanded to make it more informative than at present. It could be included as a separate financial statement to show the achievements of the Trust Fund in developing capital projects from the Trust Fund's inception.

The Public Sector Accounting and Auditing Committee of the Canadian Institute of Chartered Accountants recently issued an exposure draft entitled General Standards of Financial Statement Presentation for Governments. It proposes in relation to a government's summary financial statements that when legislation may require an accounting treatment that does not reflect the substance of the transaction or event, notes or schedules to the financial statements would be used to comply with the legislation. This guidance accords with the Auditor General's recommendation above.

2.28.4 **Treasury Branches Deposits Fund** — year ended March 31, 1986

Observations from Financial Audit Work

Accounting for loan losses — Since 1983 the Fund has accounted for and disclosed loan losses in accordance with an averaging formula used by Canadian banks. This formula has reduced the impact of high loan losses during the recent economic downturn but has also deferred the effects of the downturn to future years. It was observed during the audit that under conditions which combine asset growth and continuing high loan losses, the use of the averaging formula could result in charges to income that exceed the actual loan losses for a particular year.

To improve the disclosure of the financial position and operations of the Deposits Fund in future years, the Auditor General recommended that the Fund change its accounting policy with regard to loan losses by returning to the use of generally accepted accounting principles (GAAP). Under GAAP, the actual amount of loan losses each year would be charged against income in that year. Management has since indicated that it agrees with the recommendation and that it intends to return to the use of GAAP to account for loan losses in the year ended March 31, 1987.

Electronic Data Processing — Following a system audit performed in 1983, and at the conclusion of subsequent audits, the Auditor General reported to Management that EDP systems development was not adequately serving its information needs. Specific recommendations were made concerning EDP systems to monitor and control loans, deposits and non-interest expenses. The Auditor General also recommended that Management formulate an EDP plan that had Management's confidence and addressed Management's concerns over the strategy used for systems development.

The Auditor General was gratified to note, during the audit for the year ended March 31, 1986, that progress has been made towards the acquisition and implementation of a comprehensive accounting system and an interactive branch banking system.

2.28.5 Financial audits of the following were also completed:

Land Purchase Fund - year ended March 31, 1986
Treasury Revolving Fund - year ended March 31, 1986
Alberta Heritage Foundation for Medical Research Endowment Fund - year ended March 31, 1986
Alberta Heritage Scholarship Fund - year ended March 31, 1986
Alberta Provincial Corporation Loan Fund - year ended March 31, 1986
Pension Fund - year ended March 31, 1986
Utility Companies Income Tax Rebates Fund - year ended March 31, 1986
Alberta Municipal Financing Corporation - year ended December 31, 1985
Bond and Coupon Accounts:
    Matured Interest - year ended March 31, 1986
    Unpresented Debentures - year ended March 31, 1986
Consolidated Cash Investment Trust Fund - year ended March 31, 1986
General Trust Account - year ended March 31, 1986
Payroll Deductions Trust - year ended March 31, 1986
A.L. Sifton Estate - year ended March 31, 1986
Ultimate Heir Trust Fund "A" - year ended March 31, 1986
Ultimate Heir Trust Fund "B" - year ended March 31, 1986

2.29 UTILITIES

Of the matters reported to management, the observations and recommendation below are those which the Auditor General considers should be brought to the attention of the Legislative Assembly.

2.29.1 **Gas Alberta Operating Fund** — year ended March 31, 1986

Observations arising from Financial Audit Work

In two respects, it appears that the operations of the Gas Alberta Operating Fund did not comply with, or contributed to non-compliance with, the prevailing legislative authorities during 1985-86.

The Utility Companies Income Tax Rebates Regulation directs that wholesale customers be granted Provincial discount in their periodic billings for gas sold to them. The Regulation further requires wholesale customers to pass on the discount to their retail customers, and indicate on the billings to retail customers the amount of Provincial discount. The audit revealed that from January 1986, billings to distributors for gas sold to them by the Fund did not indicate the amount of relevant Provincial discount. Failure to disclose the Provincial discount on these billings means that distributors will be unable to provide details to their retail customers of the Provincial discount passed on.

In anticipation of a proposed change to the Utility Companies Income Tax Rebate Regulation, the practice of showing Provincial discount on billings by the Fund to wholesale customers was discontinued. It was proposed that customers would be notified of discounts once each year, but the legislative amendments necessary had not been obtained at that time.

Section 29(1)(d) of the Rural Gas Act allows the Minister to enter into an agreement or arrangement with a distributor to provide customer billing services. Section 30(5) of the Act specifies that any expenditures made pursuant to such agreements are to be paid out of the Fund. The audit revealed, however, that expenditures in respect of the retail billing system are not paid out of the Fund, but are borne by the Department of Utilities.

Revenue from the billing services is recorded as income of the Fund. Management of the Fund contend that the intent of enabling legislation is for Gas Alberta to operate solely as a broker for gas purchases and sales and that administration costs, including the cost of the retail billing system, are not to be charged to the Fund. This suggested intent however is not supported by the prevailing legislation, and the accounting concept of matching revenues with related costs is not appropriately followed in respect of the retail billing service.

In the management letter to the Deputy Minister at the conclusion of the audit of the Fund, the Auditor General made the following recommendation:

Recommendation No. 49

It is recommended that the Department of Transportation and Utilities:

- *clarify the applicability of the Utility Companies Income Tax Rebates Regulation relative to the Gas Alberta Operating Fund and the rural gas distributors. If it is determined that the Regulations apply, then periodic billings to distributors should include the amount of Provincial discount which has been passed on, and*

- *pay out of the Gas Alberta Operating Fund costs associated with any agreement or arrangement entered into under section 29(1)(d) of the Rural Gas Act, or consider amending the Act.*

2.29.2 Financial audits of the following were also completed:

Department of Utilities
Natural Gas Rebates Fund
Rural Electrification Revolving Fund
Alberta Electric Energy Marketing Agency

All of these were audited for the fiscal year ended March 31, 1986.

2.30 OTHER

This section of the Auditor General's report deals with audits of various entities which have not been dealt with in the foregoing sections. Essentially, these are irrigation districts, section 12(b) audits and the Province's lottery operations.

Of the matters reported to management, the observations and recommendations below are those which the Auditor General considers should be brought to the attention of the Legislative Assembly.

2.30.1 Irrigation Districts

The Auditor General is auditor of fourteen irrigation districts operating under the authority of the Irrigation Act, Chapter I-11, Revised Statutes of Alberta 1980. These irrigation districts are not provincially owned but receive cost-sharing funding for capital improvements from the Province of Alberta, particularly from the Alberta Heritage Savings Trust Fund. The Auditor General is appointed auditor of these districts under section 43 of the Irrigation Act. The irrigation districts are:

Aetna Irrigation District
Bow River Irrigation District
Eastern Irrigation District
Leavitt Irrigation District
Lethbridge Northern Irrigation District
Macleod Irrigation District
Magrath Irrigation District
Mountain View Irrigation District
Raymond Irrigation District
Ross Creek Irrigation District
St. Mary River Irrigation District
Taber Irrigation District
United Irrigation District
Western Irrigation District

The financial statements of the fourteen irrigation districts were audited to various year-ends within the 1985-86 fiscal year.

The irrigation districts are independently incorporated with no direct accountability to the Legislative Assembly. Accordingly, their audited financial statements are not published in the public accounts of the Province.

2.30.2 Section 12(b) Audits

Pursuant to section 12(b) of the Auditor General Act, the Auditor General may, with the approval of the Select Standing Committee on Legislative Offices, be appointed auditor of organizations other than Provincial departments, funds and agencies. For accounting periods ended within the 1985-86 fiscal year, the Audit Office audited the financial statements of the following pursuant to section 12(b):

ACCESS Charitable Foundation
Alberta Children's Hospital Research Centre
Banff Television Foundation
Centre for Frontier Engineering Research Institute
Foothills Hospital Employees' Charity Fund
Foothills Hospital Foundation

Glenrose Rehabilitation Hospital Employee Benevolent Fund
Glenrose Rehabilitation Hospital Employee Charities Fund
Grande Prairie Regional College Foundation
Olds College Foundation
Sulphur Development Institute of Canada (SUDIC)
Technical Resource Centre Society for Technology and Rehabilitation
The University of Alberta Foundation
The Trustees of the Academic Staff Benefits Plans of The University of Alberta
University of Alberta Hospitals Employees' Benevolent Fund
University of Alberta Hospitals Employees' Charities Trust

Observations from Current Financial Audit Work

The Auditor General's reports on the financial statements of

Banff Television Foundation,
Foothills Hospital Foundation,
Grande Prairie Regional College Foundation,
Olds College Foundation, and
Technical Resource Centre Society for Technology and Rehabilitation

contained reservations of opinion because, as explained in section 3.2.2 of this report, they receive donation revenue which is not susceptible of audit verification. Furthermore, the Auditor General's report on the financial statements of

Sulphur Development Institute of Canada (SUDIC)

contained a reservation of opinion because, as explained in section 3.2.7 of this report, it receives membership fees and royalty revenues that are not susceptible of audit verification.

2.30.3 Lottery Operations

The manner in which the proceeds of the major lotteries currently operating in Alberta are dealt with, the payments of administration costs and prize money therefrom, and the distribution of net profits earned from those lotteries, appear to lack appropriate legislative authority.

In his last two annual reports the Auditor General commented on the manner in which the proceeds of the major lotteries currently operating in Alberta are dealt with. These are the Provincial, Superloto, Lotto 6/49, Western Express and Lotto West lotteries. The licence issued pursuant to the Interprovincial Lottery Act purports to authorize the Western Canada Lottery Corporation, a Winnipeg-based organization, to act on behalf of the Province as general administrator of the above lotteries. As general administrator, its activities include receiving the proceeds of ticket sales, paying administration costs and prize money, distributing net profits and investing any undistributed funds.

A legal opinion obtained by the Auditor General indicates that the proceeds from these lotteries fall within the definition of "public money" that should be paid into the Province's General Revenue Fund. The Interprovincial Lottery Act makes no "special disposition" that would allow the proceeds to remain outside the General Revenue Fund, nor does it empower the licence to do so.

The Auditor General recommended that lottery proceeds be paid into the General Revenue Fund as required by the prevailing legislation, and that expenses or distributions from the proceeds be charged to an appropriation of the Legislature. He noted, however, that if the Government would prefer that lottery proceeds not be paid into the General Revenue Fund, then legislation should be enacted to create a special statutory fund or a Provincial agency through which the receipt and

disbursement of lottery proceeds would pass. Alternatively, the Interprovincial Lottery Act could be revised to provide that the lottery proceeds be "specially disposed of" so as to constitute an exception to the requirement that they be paid into the General Revenue Fund. The Auditor General also recommended that, arising out of the legal opinion received, a specific reference to the Criminal Code of Canada be inserted in the Interprovincial Lottery Act to place the operation of provincial and interprovincial lotteries on a more secure basis.

In a report to the Public Accounts Committee, the Provincial Treasurer responded to the Auditor General's recommendations by stating that the Minister of Career Development and Employment, to whom responsibility for lotteries was transferred in 1986, has agreed to review the matter to determine how best the receipt and disbursement of lottery funds should be handled.

At March 31, 1986, undistributed lottery proceeds held by the Western Canada Lottery Corporation amounted to approximately $58 million, of which less than $17 million was committed to beneficiaries. As the law stands at present, the uncommitted funds amounting to approximately $41 million should have been transferred to the Province's General Revenue Fund.

Recommendation No. 50

It is recommended that the Minister responsible for administering the Interprovincial Lottery Act:

— *direct that the proceeds from the Province's lottery operations be paid into the General Revenue Fund as required by the Financial Administration Act, and that administration costs, prize monies and profit distributions be paid therefrom pursuant to the authority of appropriations of the Legislature; alternatively,*

— *seek an amendment to the Interprovincial Lottery Act to remove the collection and administration of lottery proceeds from the scope of section 19(1)(b) of the Financial Administration Act.*

2.31 CROWN-CONTROLLED ORGANIZATIONS

2.31.1 Crown-controlled organizations are defined by section 1(b) of the Auditor General Act. Essentially, an entity qualifies to be so designated where more than 50% and less than 100% control exists, either through share ownership or through board or management representation. Crown-controlled organizations existing during the 1985-86 fiscal year were as follows:

Alberta Helium Limited
The University of Alberta Foundation

The Auditor General is auditor of The University of Alberta Foundation pursuant to section 12(b) of the Auditor General Act. The Foundation ceased operations in 1985 and its last financial statements were audited for the period ended October 31, 1985.

On August 29, 1985, the shareholders of Alberta Helium Limited agreed that the Company would issue additional shares for cash and "know-how". As a result, the Alberta Research Council's (and the Province's) equity in Alberta Helium Limited was reduced below 50% and the Company ceased to be a crown-controlled organization.

SECTION 3 — REPORTING CRITERIA, RESERVATIONS AND PUBLIC ACCOUNTS

3.1 REPORTING CRITERIA AND TYPES OF AUDIT

3.2 RESERVATIONS IN AUDIT REPORTS ON FINANCIAL STATEMENTS

3.3 AUDIT OF THE PUBLIC ACCOUNTS

3.4 CONSOLIDATED OPERATING STATISTICS

3.1 REPORTING CRITERIA AND TYPES OF AUDIT

3.1.1 When selecting audit findings, conclusions and recommendations for inclusion in this report, the Auditor General has exercised the discretionary powers provided by the Auditor General Act. Section 25 of the Act allows him not to include matters which are, in his opinion, immaterial or insignificant. In addition, section 19(5) allows him to refrain from reporting deficiencies in systems and procedures which he is satisfied have been or are being rectified.

When exercising these discretionary powers, the Auditor General considers the circumstances surrounding each matter subject to report. He takes into account the nature, materiality and sensitivity of the matter, and its significance relative to the individual audit entity and the Government as a whole. For system deficiencies subject to report, the speed and manner of management's corrective action is also taken into account. Assurances by management that steps have been or are being taken to eliminate observed system deficiencies will affect, though not determine, whether or not he includes the matter in an annual report.

Exercising the discretionary reporting powers provided by the Act, in the aforementioned manner, allows annual reports to concentrate on those concerns which should, in the Auditor General's opinion, be brought to the attention of the Legislative Assembly. It also enables him to influence management to correct many system deficiencies promptly without the need to report them publicly.

Communication of Audit Observations

3.1.2 The audit observations and recommendations contained in this report have undergone a rigorous process aimed at providing all concerned with opportunities to challenge or provide input.

At the conclusion of all audits, meetings (exit conferences) were held to discuss audit findings and concerns. The nature of the matters discussed depended on the nature of the audit, but included typically the form and content of financial statements, valuation provisions and allowances, the accounting policies employed, observed instances of non-compliance with legislative and other authorities, system deficiencies, control weaknesses, and related recommendations. These meetings were attended by representatives of the Audit Office and senior financial and other management officials of the audited entity.

The main purposes of these meetings were to ensure that senior management understood the audit findings, to discuss recommendations for corrective action, and to provide opportunities for management comment and reaction before the audited financial statements and the letter to management were issued. Minutes of these meetings were prepared and circulated by the Audit Office to all who attended, thereby minimizing the risk of any misunderstanding concerning observations raised and action promised.

Audit observations and recommendations judged to be of concern to senior management were incorporated into management letters to the responsible deputy minister or senior executive officer. Copies of management letters were forwarded to the appropriate minister and to the Secretary to the Treasury Board, except for those addressed to Provincial agencies which are referred to in section 2(5) of the Financial Administration Act.

Subsequently, using the criteria outlined in 3.1.1 above, the observations and recommendations considered important enough to be reported to the Legislative Assembly were selected for inclusion in this report. In the course of preparation, the report was reviewed by the Government's Audit Committee, of which the Provincial Treasurer is a member. Finally, before the annual report was published, all ministers and deputy ministers or chief executive officers were informed of observations contained in the report that relate to areas for which they are responsible.

Recommendations

3.1.3 Section 2 of the report includes a number of recommendations designed to address or eliminate the reported concerns.

The Auditor General's 1984-85 annual report was tabled in the Legislative Assembly in April 1986. Many of the recommendations contained therein required discussion and decisions by management. Others called for legislative changes and/or systems development and implementation before the problems that gave rise to the recommendations could be eliminated. For these reasons, not all matters previously reported could be dealt with fully before publication of this report.

The Provincial Treasurer has prepared a report addressed to the Select Standing Committee on Public Accounts which contains responses to recommendations in the Auditor General's report for the 1984-85 fiscal year. Many of the responses are referred to throughout this report.

Non-compliance with Legislative Authorities

3.1.4 Non-compliance with legislative authorities are reported in this report pursuant to sections 19(2)(a) and (b) of the Auditor General Act.

All transactions and activities examined in the course of auditing departments, funds and Provincial agencies in accordance with generally accepted auditing standards are also examined to determine whether they comply with the significant financial and administrative authorities that govern them. These authorities include primary authorities such as statutes, and subordinate authorities emanating therefrom such as regulations, Orders in Council, contracts and conditional grant agreements. Subordinate authorities are also examined to determine whether they have been properly issued in accordance with the provisions of a relevant primary or more senior subordinate authority.

In the opinion of the Auditor General, except for the instances of non-compliance described in this report, those transactions and activities examined in the course of auditing departments, funds and Provincial agencies complied, in all significant respects, with relevant financial and administrative authorities. The instances of non-compliance reported herein are only those that were observed and which the Auditor General believes are significant enough to be brought to the attention of the Legislative Assembly.

Types of Audit

3.1.5 Throughout section 2 of the report, the term "financial audit" is used repeatedly. In this context, a financial audit encompasses:

— audit procedures considered necessary to support the expression of an opinion on financial statements,

— a review of action taken in response to previous audit observations and recommendations, including those reported to the Legislative Assembly, and

— an examination of transactions and activities examined for other auditing purposes to determine whether they comply with the significant financial and administrative authorities that govern them.

For some audit entities, the financial audit was extended to include systems reviews or more detailed examinations beyond what was considered necessary to contribute to the expression of an opinion on the financial statements. These audit extensions are identified in section 2 of this report.

All audit findings, conclusions and recommendations arising from all types of audit activity relating to 1985-86 have been reported to management. The findings, conclusions and recommendations in section 2 of this report are those which, in the Auditor General's opinion, warrant the attention of the Legislative Assembly.

3.2 RESERVATIONS IN AUDIT REPORTS ON FINANCIAL STATEMENTS

3.2.1 Section 19(2) of the Auditor General Act requires the Auditor General to provide details herein of any reservations of opinion in reports that he has issued on financial statements. For the 1985-86 year of the Crown, he issued seventeen such reservations; viz:

3.2.2 Ten reservations of opinion were because the financial statements of:

- Alberta Cancer Foundation,
- Alberta Sport Council,
- Banff Television Foundation,
- Foothills Hospital Foundation,
- Glenbow-Alberta Institute,
- Grande Prairie Regional College Foundation,
- Olds College Foundation,
- Technical Resource Centre Society for Technology and Rehabilitation,
- The Alberta Historical Resources Foundation, and
- The Recreation, Parks and Wildlife Foundation

include revenue derived from donations. Revenue of this nature cannot be audited for completeness in accordance with generally accepted auditing standards.

These reservations of opinion do not reflect adversely on the records or the financial statements of the above entities. Rather, they are a product of the nature of donation revenue. For most types of revenue, an auditor can calculate or anticipate the completeness of recorded revenue by reference to the auditee's production or sales records, or by independent verification.

Where donations are received in significant or potentially significant amounts from the public, however, the auditor can do no more than examine the amounts that are recorded as received. He cannot verify that all donations received have been recorded.

In these circumstances, generally accepted auditing standards require the auditor to express a reservation of opinion on the financial statements by drawing attention to the nature of the revenue and describing the limited audit work that was possible.

3.2.3 Three reservations of opinion were because the financial statements of:

- Lethbridge Community College,
- Medicine Hat College, and
- Mount Royal College

were not prepared in accordance with acceptable accounting principles.

As discussed more fully in section 2.4 of this report, Lethbridge Community College and Medicine Hat College both overstated operating expenditures by including therein transfers to restricted funds. In the case of Mount Royal College, the original cost or fair market value of assets disposed of, or considered of no further value or use, had not been removed from the fixed asset accounts; only the amount of proceeds from asset disposals had been removed.

3.2.4 One reservation of opinion was because Fairview College had not included in its financial statements for the year ended June 30, 1985, the value of certain assets transferred from the Province of Alberta to the College when it received public college status in April 1978. This matter is discussed more fully in section 2.4.12 of this report.

3.2.5 One reservation of opinion was because the Auditor General was unable to satisfy himself concerning the ownership of certain assets included in the financial statements of the Alberta Research Council. This matter is discussed more fully in section 2.25.1 of this report.

3.2.6 One reservation of opinion was because the Auditor General was unable to satisfy himself concerning the value of inventories of merchandise and supplies included in the financial statements of the Southern Alberta Institute of Technology for the year ended June 30, 1985. This matter is discussed more fully in section 2.4.22 of this report.

3.2.7 One reservation of opinion was because the financial statements of the Sulphur Development Institute of Canada (SUDIC) include revenue derived from membership fees and royalty revenue that cannot be audited for completeness in accordance with generally accepted auditing standards.

This reservation of opinion does not reflect adversely on the records or the financial statements of the Institute. Rather, it is a product of the nature of these types of revenue. The difficulties inherent in auditing these revenues are similar to those for donation revenue explained in section 3.2.2 above.

3.2.8 In all other cases, the Auditor General reported without reservation that the financial statements examined present fairly the financial position of the entity at March 31, 1986 (or such other accounting period ended within the year ended March 31, 1986) and the results of its operations for the periods covered by the statements, in accordance with generally accepted accounting principles or other appropriate disclosed basis of accounting.

3.3 AUDIT OF THE PUBLIC ACCOUNTS

3.3.1 The public accounts of the Province for the year ended March 31, 1986 are published in two volumes. Volume I contains, together with the Auditor General's reports thereon, the consolidated financial statements of the Province of Alberta, the financial statements of the General Revenue Fund, and the financial statements of revolving funds, regulated funds, Provincial agencies and trust funds administered by the Government.

Volume II contains details of expenditures and revenues by department and other statements and reports included in the public accounts to comply with the Financial Administration Act and other statutes. In addition, a third volume containing details of expenditures by payee is published as supplementary information.

3.3.2 The Auditor General's report on the Province's 1985-86 consolidated financial statements was as follows:

AUDITOR'S REPORT

To the Members of the
Legislative Assembly

I have examined the consolidated statement of reported assets, liabilities and net assets of the Province of Alberta as at March 31, 1986 and the consolidated statements of revenue and expenditure and changes in financial position for the year then ended. My examination was made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as I considered necessary in the circumstances.

In my opinion, these consolidated financial statements present fairly the financial position of the Province of Alberta as at March 31, 1986 and the results of its operations and the changes in its financial position for the year then ended in accordance with the disclosed basis of accounting, considered appropriate in the circumstances, as described in Note 1 to the consolidated financial statements applied, after giving retroactive effect to the changes in accounting policy as explained in Note 2 to the consolidated financial statements, on a basis consistent with that of the preceding year.

Donald D. Salmon

C.A.
Auditor General

Edmonton, Alberta
November 14, 1986

3.3.3 The above report covers the consolidated financial statements of the Province. The Auditor General issued a similar report (see Volume I of the public accounts) which covers the financial statements of the General Revenue Fund and the detailed information of departmental expenditures and revenues contained in the first twenty-seven sections of Volume II.

The volume of supplementary information containing details of expenditure by payee is not covered by the reports mentioned in the previous paragraph since it is not an integral part of public accounts. However, the system that processes the information contained in this volume is reviewed periodically by the Audit Office.

The above Auditor's Report, together with the overall assessment in section 1.1.2 of this report, is the culmination of most of the work done each year by the Audit Office. In effect, however, the report covers more than just the consolidated financial statements and the consolidation process. It also covers the 1985-86 audits of the various consolidated entities. These include the General Revenue Fund, the Alberta Heritage Savings Trust Fund and approximately eighty Provincial agencies and other funds (see the Index).

These audits, together with the annual audits of the universities, colleges, technical institutes, hospitals and irrigation districts, are performed as explained in section 4.3 of this report, which describes audit approaches.

3.4 CONSOLIDATED OPERATING STATISTICS

3.4.1 The consolidated financial statements of the Province are an aggregation of most, though not all, of the entities administered and owned by the Province of Alberta. They combine the operating results and financial positions of the Province's General Revenue Fund, the Alberta Heritage Savings Trust Fund and the entities whose financial statements are published in sections 3 to 7 of Volume I of the public accounts.

The consolidation, however, does not include the Provincially owned universities, colleges, technical institutes, hospitals and related funds. The reasons for their exclusion and the Auditor General's comments thereon are explained in section 2.2.1 of this report.

Consolidation Methods

3.4.2 The Province of Alberta first published consolidated financial statements for 1978-79. Since then, the Government has continued to refine the consolidation methods used. In the Auditor General's view, the 1985-86 consolidated financial statements are the best available basis for reviewing the overall financial position of the Province and its operating results. He believes, however, that the statements would be improved if his recommendations in section 2.2.1 of this report were adopted.

3.4.3 The consolidated financial statements show that for the 1985-86 fiscal year, the Province recorded a consolidated net expenditure, ie. an annual deficit, of $41 million (1984-85 - $1,246 million, net revenue). They also show that at March 31, 1986, the consolidated net assets of the Province, ie. the accumulated surplus, was $12.6 billion (March 31, 1985 - $12.6 billion).

It is important that these figures be viewed in the context of the accounting policies and consolidation methods used in preparing the consolidated financial statements. Although these policies and methods are employed and accepted by some governmental jurisdictions and are explained in a note to the consolidated financial statements, they are not in several respects, the generally accepted accounting principles that apply to profit-oriented organizations.

For example, as indicated above the consolidation does not include the financial statements of the Provincially owned universities, colleges, technical institutes, and hospitals. If the recorded net assets (excluding fixed assets) of these entities were included in the consolidation, the Province's accumulated surplus at March 31, 1986 would be increased by approximately $43 million.

In addition, most of the Province's fixed assets are excluded from the consolidation. This means that the accumulated surplus at March 31, 1986 does not include the value of land, buildings, equipment, fixtures and furniture owned by the Province, or the millions of hectares of Crown lands and the resource rights that attach thereto. Similarly, the accumulated surplus does not include the value of most inventories of consumable supplies and materials at March 31, 1986. The effect of these accounting policies is that the costs of fixed assets and consumable inventories are treated as expenditures in the fiscal years in which they are acquired, rather than in the years in which they are consumed or the benefits from their acquisition are realized.

An exception to the accounting policy of excluding fixed assets and consumable inventories from the consolidation is the treatment of those entities designated "commercial enterprises" by the Provincial Treasurer. Although the assets and liabilities of commercial enterprises are not aggregated on a line-by-line basis in the consolidated financial statements, they are recorded therein on an equity accounting basis. This has the effect of including the value of their inventories and the depreciated value of their fixed assets in the computation of the accumulated surplus of the Province. Entities designated commercial enterprises are:

Alberta Intermodal Services Ltd.
Alberta Liquor Control Board
Alberta Terminals Ltd.
The Alberta General Insurance Company
The Alberta Government Telephones Commission
The Workers' Compensation Board
Treasury Branches Deposits Fund

The Treasury Department's rationale for including the assets of these entities is that the assets will be used in future fiscal periods to earn revenue. The remainder of the Province's fixed assets are not included in the consolidated net assets. It is impossible for the Audit Office to estimate, with any degree of accuracy, the value of the excluded fixed assets and consumable inventories.

Regardless of the valuation method used, it is obvious that including all of the Province's fixed assets and consumable inventories in the consolidated statements would increase significantly the Province's accumulated surplus at March 31, 1986.

Another accounting policy that has a significant impact on the accumulated surplus is the method used to account for the Province's pension plan liabilities. As explained in section 2.2.1 of this report, the unfunded portion of the Province's pension plan liabilities is recorded in a footnote to the consolidated financial statements. Hence, it is not included in the computation of the accumulated surplus. Depending on the assumptions made in calculating the liability, and assuming that no portion of it is deferred, including the full liability for pension plan obligations, as calculated at March 31, 1985, would reduce the Province's accumulated surplus at March 31, 1986 by more than $5 billion.

3.4.4 The Province's consolidated operating results for the three years ended March 31, 1986 were as follows:

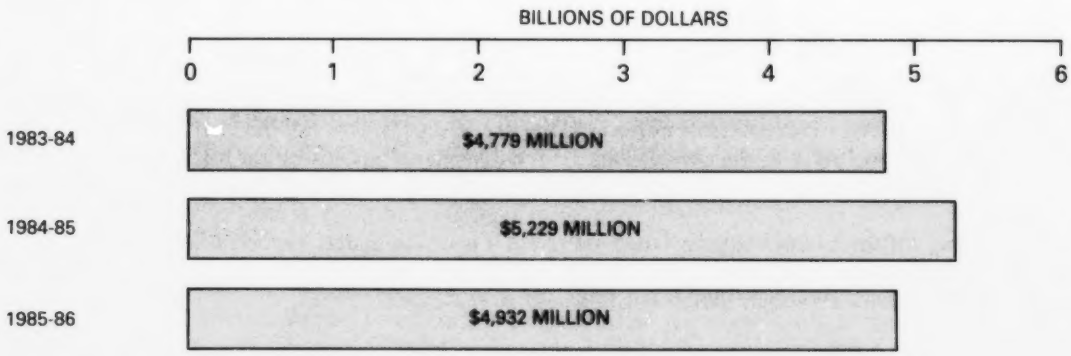
	1983-84	1984-85	1985-86
		(Millions of Dollars)	
Revenue	$11,460	$12,786	$12,757
Expenditure	11,334	11,540	12,798
Annual surplus (deficit)	126	1,246	(41)
Accumulated surplus at beginning of year	11,262	11,388	12,634
Accumulated surplus at end of year	$11,388	$12,634	$12,593

3.4.5 Consolidated revenue comprises:

	1983-84	1984-85	1985-86
		(Millions of Dollars)	
Taxes	$ 2,759	$ 2,785	$ 2,852
Non-renewable resource revenue	4,779	5,229	4,932
Payments from Government of Canada	1,274	1,647	1,742
Fees, permits and licenses	467	513	587
Trading profits	163	369	276
Investment income	1,852	2,042	2,160
Other	166	201	208
	$11,460	$12,786	$12,757

3.4.6 The following charts and comments illustrate and explain some of the more significant variances and trends in the Province's consolidated revenue during the three years ended March 31, 1986:

Non-Renewable Resource Revenue



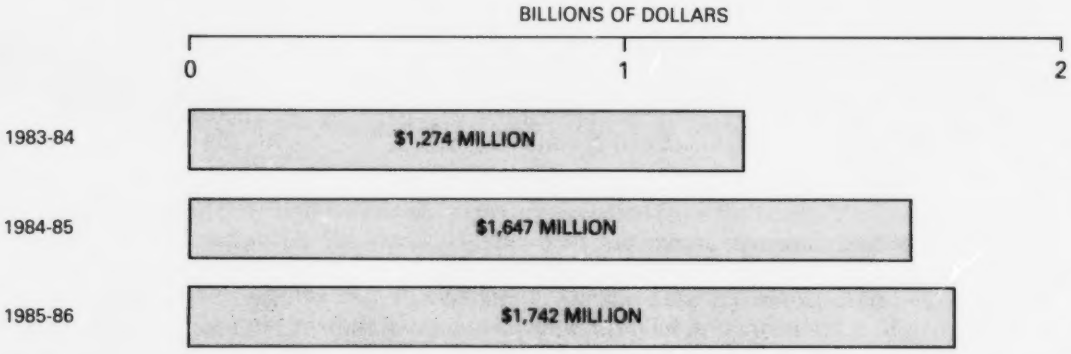
Non-renewable resource revenue increased by $450 million or 9.4% in 1984-85 compared to the previous fiscal year, and decreased by $297 million or 5.7% in 1985-86 compared to 1984-85.

The main reasons for the 1985-86 decrease were:

— crude oil royalty decreased by $382 million. The price of oil declined, especially in the first quarter of 1986 and production reduced as prices declined. Furthermore, there was a reduction in the marginal royalty rate; and

— natural gas and by-products royalty decreased by $136 million. The median price of gas was lower; export sales were lower; and there was a reduction in the marginal royalty rate.

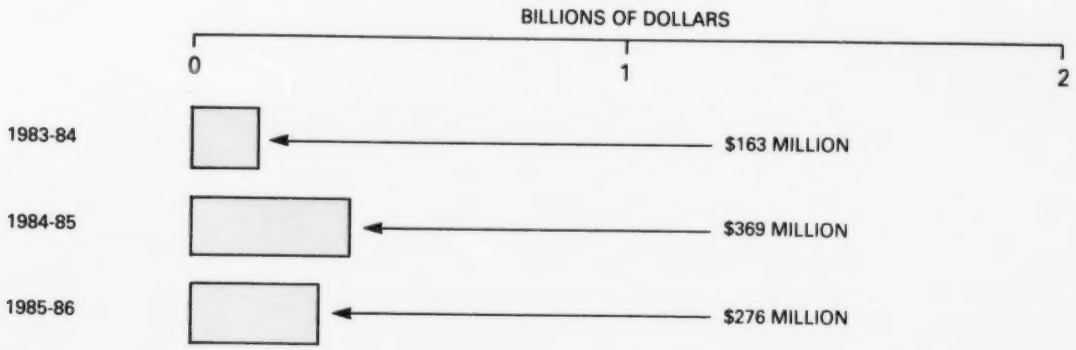
Payments from the Government of Canada



Payments from the Government of Canada increased by $373 million or 29.3% in 1984-85 compared to the previous fiscal year, and by $95 million or 5.8% in 1985-86 compared to 1984-85.

The main reasons for the 1985-86 increase were a $109 million increase in funding from the Crop Reinsurance Fund of Canada for Alberta to cover increased indemnities expenditure of Alberta Hail and Crop Insurance Corporation, and miscellaneous increases amounting to $102 million. These increases were offset by a decrease of $116 million in oil export charge payments from the Government of Canada which were discontinued with effect from June 1, 1985 in connection with oil price deregulation.

Trading Profits



Trading profits increased by $206 million or 126.4% in 1984-85 compared to the previous year, and decreased by $93 million or 25.2% in 1985-86 compared to 1984-85.

The main reason for the 1984-85 increase was an increase of $155 million in the income of The Workers' Compensation Board. The main reasons for the 1985-86 decrease were:

— an increase of $88 million in the net deficit of the Treasury Branches Deposits Fund resulting in the main from an increase of $77 million in net loss experience on loans; and

— a decrease of $74 million in the income of The Workers' Compensation Board resulting in the main from an increase of $37 million in the operating deficit and a reduction of $32 million in the net transfers from reserves and the pension fund.

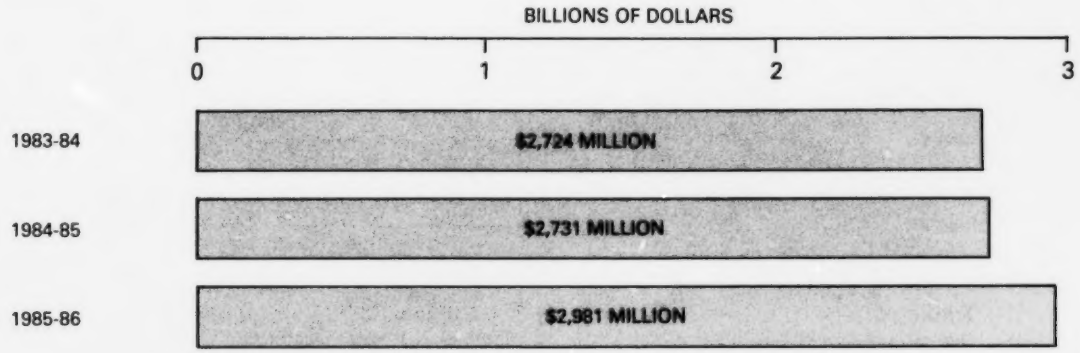
These decreases, amounting to $162 million were offset by other increases of $69 million.

3.4.7 Consolidated expenditure comprises:

	1983-84	1984-85	1985-86
		(Millions of Dollars)	
Health	$ 2,724	$ 2,731	$ 2,981
Education	2,249	2,385	2,547
Social services	986	1,052	1,180
Regional planning and development	610	700	724
Housing	427	147	103
Recreation and culture	199	227	236
Environment	181	147	169
Resource conservation and industrial development	1,353	1,423	1,934
Transportation and utilities	1,395	1,348	1,496
Protection of persons and property	383	388	412
General government	659	661	658
Valuation adjustments	168	331	358
	$11,334	$11,540	$12,798

3.4.8 The following charts and comments illustrate and explain some of the more significant variances and trends in the Province's consolidated expenditure:

Health



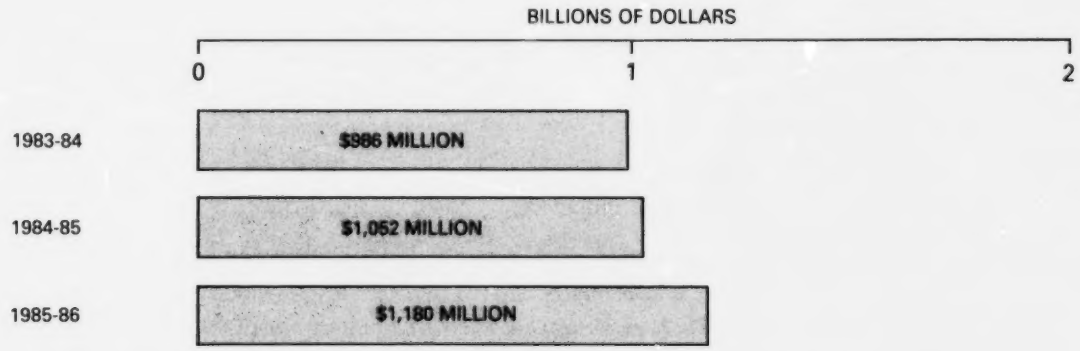
Health expenditure increased by $7 million or 0.3% in 1984-85 compared to the previous year, and increased by $250 million or 9.2% in 1985-86 compared to 1984-85.

The main reasons for the 1985-86 increase were:

— the cost of Financial Assistance for Active Care Hospitals increased by $81 million. This increase was largely due to the opening of newly constructed facilities and expanded programs approved by the Department of Hospitals and Medical Care and provided by the hospitals.

— the expenditures of the Health Care Insurance Fund increased by $67 million. Increased utilization of health care facilities was the major cause of the increase. There was also an increase in the number of persons eligible for Blue Cross Non-Group Benefits and Extended Health Benefits.

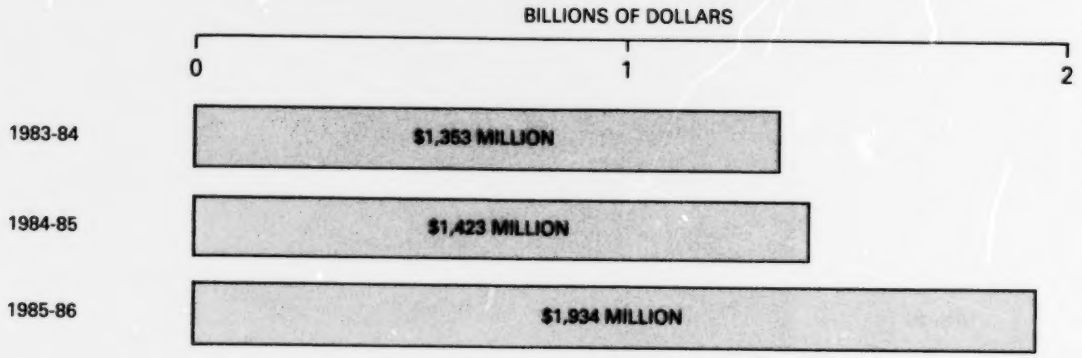
Social Services



Social services expenditure increased by $66 million or 6.7% in 1984-85 compared to the previous year, and increased by $128 million or 12.2% in 1985-86 compared to 1984-85.

The main reason for the 1985-86 increase was the increased number of social allowance recipients, particularly in the single parent family and employable categories. In addition, there was an increased cost in the year on a per client basis due to clients remaining on social allowance for longer periods.

Resource Conservation and Industrial Development



Resource conservation and industrial development increased by $70 million or 5.2% in 1984-85 compared to the previous year, and increased by $511 million or 35.9% in 1985-86 compared to 1984-85.

The main reasons for the 1985-86 increase were:

— the cost of the Production Assistance Program of the Department of Agriculture increased by $153 million. The increase arose in the main from:

  — $43 million for the Alberta Red Meat Interim Insurance Program to assist livestock producers,

  — $41 million for the Alberta Livestock Assistance Program to provide assistance to cattle, sheep, horse, goat and bison producers in maintaining viable breeding herds,

  — $33 million for the Alberta Feed Grain Market Adjustment Program to provide assistance in retaining the viability of Alberta's livestock industry by offsetting the distortions in Alberta's feed grain prices.

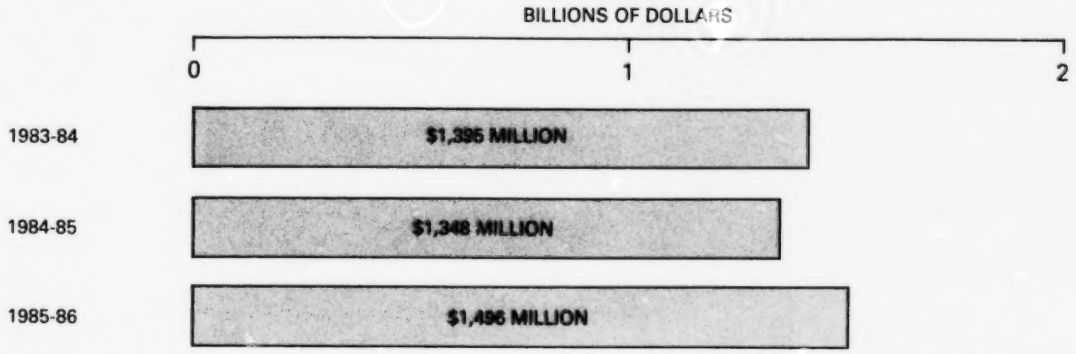
— the indemnities expenditure of Alberta Hail and Crop Insurance Corporation increased by $58 million.

— the cost of the Alberta Farm Fuel Distribution Allowance Program increased by $57 million due to an increase in the rebate rate from 7 cents to 14 cents per litre during 1985-86.

— grants made by the Alberta Petroleum Incentives Program with the express goal of encouraging oil and gas exploration and development within the Province increased by $54 million.

— the $51 million cost of the Ethane Feedstock Price Equalization Program which commenced on April 1, 1985.

Transportation and Utilities



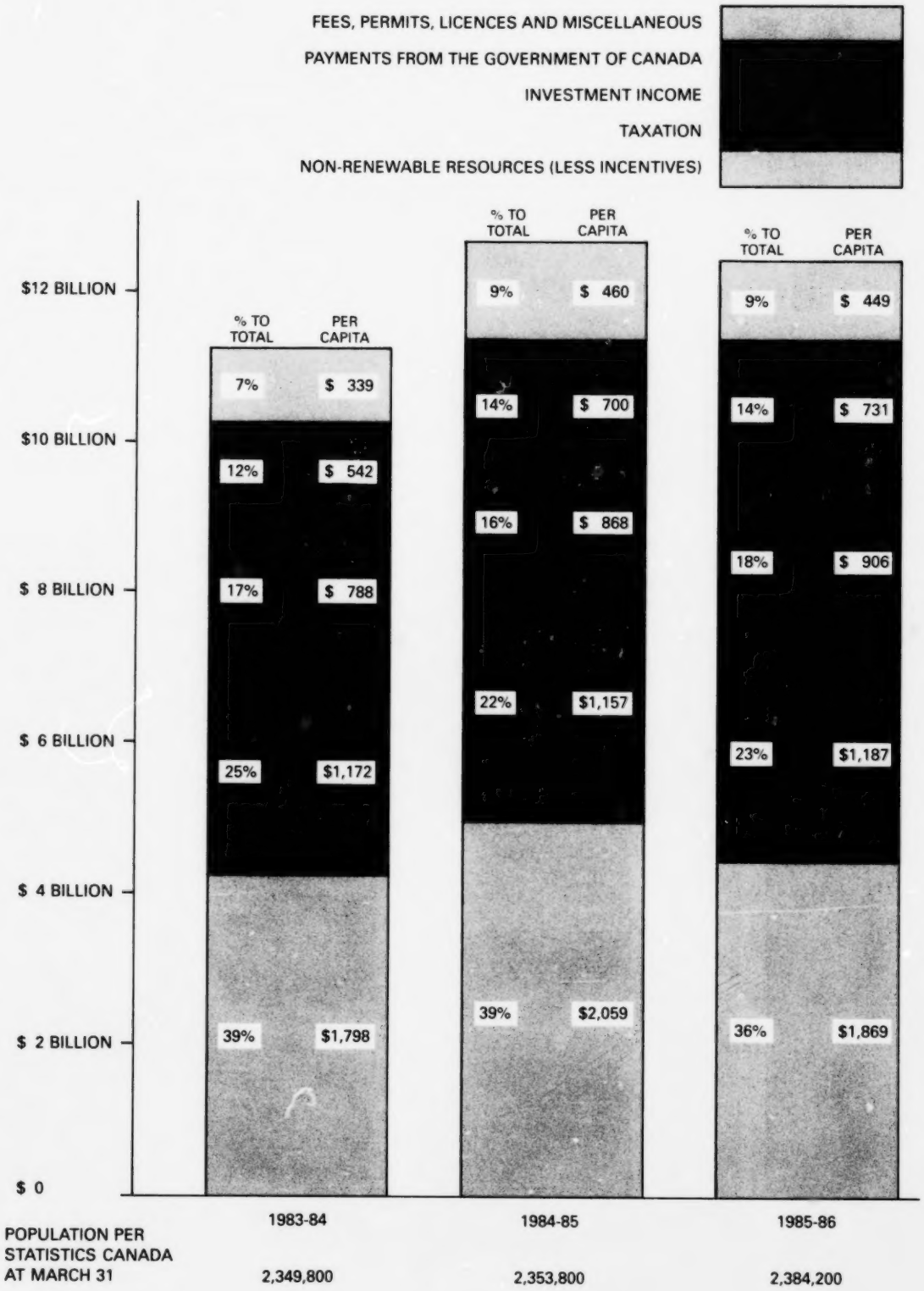
Transportation and utilities expenditure decreased by $47 million or 3.4% in 1984-85 compared to the previous year, and increased by $148 million or 11.0% in 1985-86 compared to 1984-85.

The main reason for the 1985-86 increase was that the 1984-85 construction of highways season was shortened by the early arrival of winter. Approximately $36 million of work could not be completed because of freeze-up and was carried forward and made additional to the Department of Transportation's 1985-86 budget. As equivalent costs were budgeted and incurred in 1985-86, the Department's expenditures on construction of highways showed an increase of $72 million when compared to 1984-85.

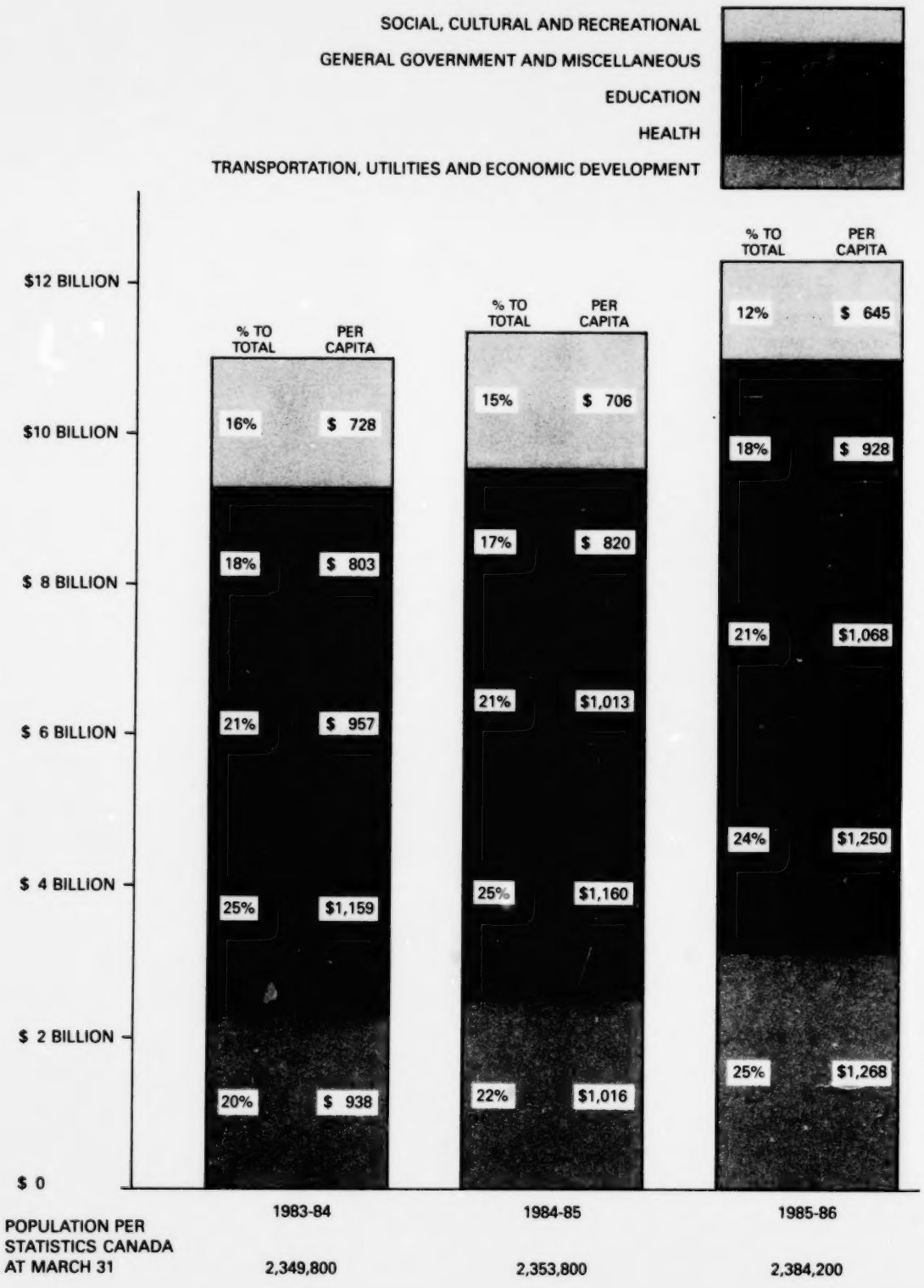
3.4.9 The financial information in the public accounts is displayed in a way that satisfies the prevailing legislation and is in accordance with acceptable government reporting practices. The following charts display some of the same financial information in an alternative and simplified manner, and are included in this report pursuant to subsection 19(3)(b) of the Auditor General Act.

In preparing the charts, some revenues and expenditures have been grouped on a generic basis rather than the basis used in the public accounts. For example, in the charts freehold mineral tax is included in non-renewable resource revenue, whereas in the public accounts it is included in tax revenue. Non-renewable resource revenue (net) in the charts is the revenue after deducting from gross non-renewable resource revenue, costs under the various incentive programs that can be said to relate to the generation of that revenue, viz. royalty tax credits and rebates, petroleum incentive program grants, and geophysical and exploratory drilling incentives. In the public accounts, royalty tax rebates are reflected as deductions from tax revenue, while some costs under the other incentive programs are reflected as resource conservation and industrial development expenditures.

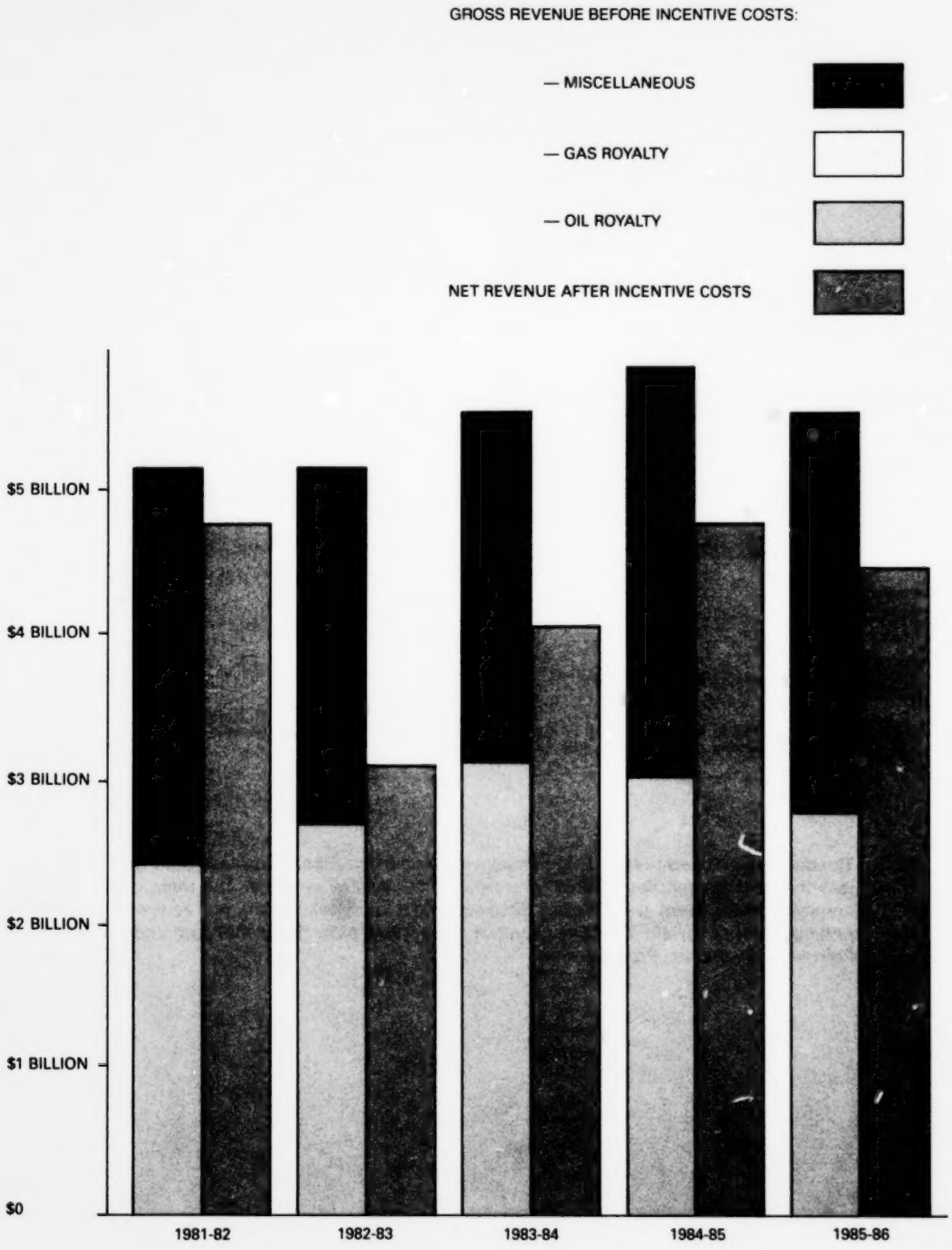
3.4.10 The following chart shows consolidated revenue by major groups, the percentage of such revenue to total consolidated revenue, and revenue per capita, for the past three years. (Prior years' figures have been reclassified where necessary to conform to 1985-86 presentation).



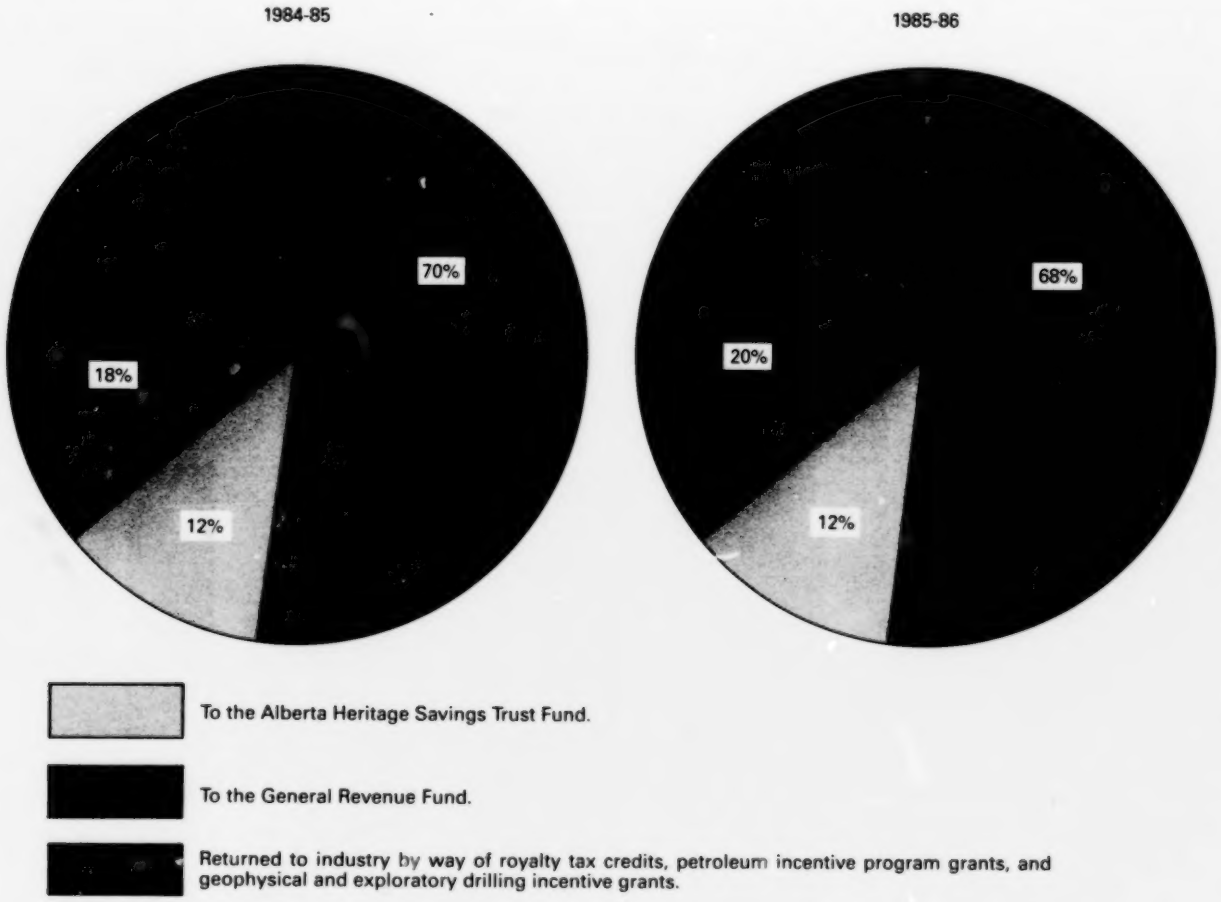
3.4.11 The following chart shows consolidated expenditure by major groups, the percentage of such expenditure to total consolidated expenditure, and expenditure per capita, for the past three years. (Prior years' figures have been reclassified where necessary to conform to 1985-86 presentation).



3.4.12 The following chart shows non-renewable resource revenue for 1981-82 to 1985-86 before allocations to the Alberta Heritage Savings Trust Fund.



3.4.13 The following chart compares the disposition of non-renewable resource revenue between 1984-85 and 1985-86.



NOTE: The disposition of non-renewable resource revenue to the Alberta Heritage Savings Trust Fund is less than the percentages stated in legislation for several reasons. The main one is that the annual transfer from the General Revenue Fund is calculated on non-renewable resource revenues net of certain incentive program costs, principally the grants paid under the Alberta Petroleum Incentives Program.

SECTION 4 - THE AUDIT OFFICE

Reported pursuant to section 19(1)(a) of the Auditor General Act

4.1 ROLE OF THE AUDITOR GENERAL

4.2 REPORTING RESPONSIBILITIES

4.3 AUDIT APPROACHES

4.4 ORGANIZATION OF THE AUDIT OFFICE

4.1 ROLE OF THE AUDITOR GENERAL

4.1.1 The Audit Office operates under the Auditor General Act to add credibility to the financial reporting of the Government of Alberta and to comment on the Province's financial administration. The Act deals with the role of the Auditor General in terms of his reporting responsibilities. Only by inference, however, does it deal with what those reports should attempt to achieve and how the role of the Auditor General should impact the financial administration of the Province's affairs.

Adding Credibility

4.1.2 A major role of all auditors is to provide assurance that financial information is reliable. In the private sector, for example, auditors provide assurance to shareholders of corporations that the financial statements issued by management are fairly presented. Similarly, legislative auditors provide assurance to their legislative bodies that the financial and other accountability information issued by governments is fairly presented.

4.1.3 To appreciate the significance of a legislative auditor's role, it is necessary to understand the importance of accountability. In simple terms, accountability is the process by which governments are "held accountable" for complying with and not exceeding the authorities provided by their legislative bodies. These authorities may be primary authorities such as statutes, or subordinate authorities issued pursuant to primary authorities such as Orders in Council, regulations, ministerial orders, policy directives, corporation by-laws, contracts, agreements and administrative manuals. By providing authorities and requiring compliance with them, legislative bodies control the administration of their jurisdictions. Periodically, the individuals and entities that receive these authorities must report back on how the authorities were exercised. Naturally, the form of these reports will depend on the nature of the authorities provided.

Accountability reports not only show legislative bodies how the authorities they have issued were exercised, they also frequently provide a basis for future policy decisions. Hence, it is important that the information reported be accurate and fairly stated. The work of independent legislative auditors, therefore, adds credibility to accountability reports and provides assurance to legislators that their decisions are based on reliable information.

The Auditor General's role, in this regard, can be illustrated by describing the accountability process as it relates to the Province's annual expenditure Appropriation Acts. Each year, the Government of Alberta presents its expenditure budgets (estimates) for debate in the Legislative Assembly. Once the estimates are formally approved by the Legislature, the Government and its administrators are responsible for their implementation. In this way, the Assembly delegates authority to the Government to disburse funds for the approved purposes, to manage resources in an economic and efficient manner, and to evaluate the effectiveness of the programs involved.

This authority carries a responsibility to report back to the Legislative Assembly on how the funds and resources were administered.

4.1.4 The principal accountability information of a financial nature tabled in the Legislative Assembly is the annual public accounts of the Province. These are prepared by the Treasury Department and tabled by the Provincial Treasurer. Each set of financial statements contained therein includes a report by the Auditor General as to whether, in his opinion, the financial statements present fairly the financial position, results of operations and, where appropriate, changes in financial position of the entity concerned, in accordance with an appropriate disclosed basis of accounting and whether that basis has been consistently applied. Because of his independent status and his position as an officer of the Legislature, the Auditor General's opinions add credibility to the accountability information contained in the public accounts.

Accountability information is also subject to scrutiny by the Select Standing Committee on Public Accounts. This all-party committee acts on behalf of the Members of the Assembly in conducting an in-depth examination of the Government's management and control of public resources. Here again, the Auditor General impacts the accountability process by issuing an annual report (this report) which may be used as a guide by the Select Standing Committee in its review of the public accounts and the activities of individual departments, Provincial agencies and regulated and revolving funds.

Financial Administration

4.1.5 Adding credibility to accountability information, however, is only one of the functions of a legislative auditor. The auditor also advises financial managers on systems designed to strengthen internal control, to detect irregularities, to promote economy and efficiency and to control and administer resources. The auditor also provides assurance, or otherwise, to senior management of departments, funds and Provincial agencies as to the adequacy of their financial administration. Through his annual reports, he also provides similar assurance to the Legislative Assembly on the financial administration of the Province. In addition, there is little doubt that the knowledge that their work will be audited every year has a salutary effect on staff who might otherwise be tempted to misuse public monies.

Auditing Standards and Accounting Principles

4.1.6 Although the Auditor General Act prescribes the Auditor General's reporting responsibilities, it is silent as to the auditing standards that are appropriate to discharge those responsibilities. The Auditor General believes, however, that the work of his Office should adhere, as a minimum, to the contemporary auditing standards that apply to chartered accountants.

The standards that apply to the auditors of public sector entities are to be found in Statements issued by the Public Sector Accounting and Auditing Committee (PSAAC). The Auditing Recommendations of the Committee are intended to apply to entities in the public sector. In the absence of such recommendations, auditors of public sector entities have regard to the Auditing Recommendations in the Members' Handbook of the Canadian Institute of Chartered Accountants (CICA). In effect, PSAAC Auditing Recommendations supplement the CICA Handbook Auditing Recommendations to the extent necessary to recognize special circumstances in public sector auditing.

Accounting policies are the specific accounting principles used by a reporting entity and the methods for applying those principles. Appropriate accounting policies are those that result in fair disclosure of financial information. Profit-oriented entities in the public sector should adhere to the Accounting Recommendations in the CICA Handbook. Other entities in the public sector may base their accounting policies either on the PSAAC Accounting Recommendations or the CICA Handbook Accounting Recommendations, selecting the basis that is the more appropriate to their individual objectives and circumstances. The basis chosen should be disclosed and consistently applied.

To date, PSAAC has issued three Accounting Statements:

1. Disclosure of Accounting Policies
2. Objectives of Government Financial Statements
3. General Standards of Financial Statement Presentation for Governments

Statements 2 and 3 identify and describe objectives and standards for summary (ie. consolidated) financial statements.

4.1.7 The financial statements of Alberta's Provincial entities are prepared in accordance with generally accepted accounting principles as set out in the CICA Handbook or alternatively, in accordance with an appropriate disclosed basis of accounting.

Because the departures from generally accepted accounting principles are so numerous and significant with respect to the Province of Alberta Consolidated Financial Statements and the General Revenue Fund, the Provincial Treasurer has considered it appropriate to omit reference to generally accepted accounting principles. The notes to these financial statements headed 'Significant Accounting Policies and Reporting Practices' explain the basis of accounting used.

4.1.8 It is worth noting that in all material respects the financial statements of Alberta's Provincial entities comply with the recommendations contained in PSAAC Accounting Statement 1 - Disclosure of Accounting Policies. Moreover, the Province of Alberta has formally adopted the objectives set out in PSAAC Accounting Statement 2 - Objectives of Government Financial Statements, by including them in the Treasury Department's Manual of Financial Administration.

4.2 REPORTING RESPONSIBILITIES

4.2.1 The Auditor General reports to the Legislative Assembly under sections 18, 19 and 20 of the Auditor General Act, and to management under section 28 of the Act. In addition, specially requested reports are issued from time to time under section 17 of the Auditor General Act.

Section 18 Reports

4.2.2 In a report issued under section 18 of the Act, the Auditor General states whether, in his opinion, the financial statements present fairly the financial position, results of operations and changes in financial position of the Crown in accordance with the disclosed accounting principles, and whether they are on a basis consistent with those of the preceding year. A report of this nature is similar to reports issued by auditors on financial statements of private sector organizations audited in accordance with generally accepted auditing standards.

The section 18 report for the 1985-86 fiscal year was dated November 14, 1986 and is reproduced in section 3.2.2 of this report. Similar reports were issued on the financial statements of all entities of which the Auditor General is auditor. These reports are annexed to the related financial statements, most of which are contained in the public accounts of the Province.

Section 19 Reports

4.2.3 In a report issued under section 19 of the Act (this report), the Auditor General reports to the Legislative Assembly on the work of the Audit Office, and various other matters specified in section 19 of the Act, that were observed during the course of that work. There is virtually no limitation to what may be included in a section 19 report, since the Act empowers the Auditor General to call attention to any matter that he considers should be brought to the attention of the Legislative Assembly.

Section 20 Reports

4.2.4 In a report issued under section 20 of the Act, the Auditor General may report to the Legislative Assembly on any matter of importance or urgency that, in his opinion, should not be deferred until presentation of his annual report issued under section 19 of the Act.

No reports were issued under section 20 of the Act in respect of the fiscal year ended March 31, 1986.

Section 28 Reports

4.2.5 Reports issued under section 28 of the Act are more commonly referred to as management letters. The purpose of management letters, as explained more fully in section 3.1.2 of this report, is to communicate to management system weaknesses and deficiencies together with other matters observed during audits.

Management letters are addressed to the deputy minister or senior executive officer of the audited entity. Copies of most management letters are sent to the minister responsible for the audited entity and to the Secretary to the Treasury Board (except for Provincial agencies referred to in section 2(5) of the Financial Administration Act). Management letters are not made available to the Legislative Assembly or its select standing committees, nor are they required to be by the Auditor General Act.

Section 17 Reports

4.2.6 Under section 17 of the Auditor General Act, the Legislative Assembly and the Executive Council may ask the Auditor General to perform special duties. Whether or not those duties result in

reports, and to whom the reports are issued, depends on the terms of the request. During the 1985-86 fiscal year, the Auditor General received no requests to perform special duties pursuant to section 17 of the Auditor General Act.

Audit Committee and the Select Standing Committee on Legislative Offices

4.2.7 Reports issued by the Auditor General under sections 19 and 20 of the Auditor General Act are tabled in the Legislative Assembly by the Chairman of the Select Standing Committee on Legislative Offices. Before being tabled, however, they are reviewed by an Audit Committee established under section 21 of the Act. The members of this Committee, all of whom are appointed by Order in Council, are as follows:

Mr. Haughton G. Thomson, F.C.A.
Retired Partner
Deloitte Haskins & Sells, Chartered Accountants
Edmonton

Mr. Elvin A. Christenson, F.C.A.
Retired Partner
Thorne Riddell, Chartered Accountants
Edmonton

Mr. Robert Colborne
President
Pacific Western Transportation Limited
Calgary

His Honour Clare L. Liden
Assistant Chief Judge
Provincial Court of Alberta

Mr. Robert A. McLaughlin
Retired Systems Analyst
Edmonton

Mr. William G. Stephen, F.C.A.
Partner
Stephen Johnson, Chartered Accountants
Calgary

The Hon. Dick Johnston, F.C.A.
Provincial Treasurer of Alberta

The Auditor General acknowledges the helpful and constructive contributions of the Audit Committee during the review stage of the annual report for the 1985-86 fiscal year.

During 1985-86, members of the Select Standing Committee on Legislative Offices were as follows:

Dr. C.R. Elliott, M.L.A. Chairman
Dr. D.J. Carter, M.L.A. Deputy Chairman
Mr. D. Anderson, M.L.A.
Dr. W.A. Buck, M.L.A.
Mr. J. Gurnett, M.L.A.
Mr. A. Hiebert, M.L.A.
Mr. J.E. Miller, M.L.A.
Mr. W. Purdy, M.L.A.
Mr. J. Thompson, M.L.A.

The present members of the Committee are:

Mr. G. Stevens, P. Eng., M.L.A. Chairman
Mr. S.B. Day, M.L.A. Deputy Chairman
Dr. W.A. Buck, M.L.A.
Mr. G. Clegg, M.L.A.
Mr. J. Drobot, M.L.A.
Dr. C.R. Elliott, M.L.A.
Mr. D. Fox, M.L.A.
Mr. G. Mitchell, M.L.A.
Mr. F.A. Stewart, M.L.A.

The Auditor General acknowledges the rapport with this Committee that has enhanced the Audit Office's accountability to the Legislature.

4.3. AUDIT APPROACHES

4.3.1 The audit approaches developed by the Audit Office reflect the relative importance of the Auditor General's reporting responsibilities.

The most important of these responsibilities derive from sections 18, 19 and 28 of the Auditor General Act, and are:

(i) to report on the annual financial statements of all departments, funds and Provincial agencies in accordance with generally accepted auditing standards, and

(ii) to report to management and, where appropriate, to the Legislative Assembly:

- instances observed of non-compliance with legislative authorities,
- situations where it is observed that assets are inadequately accounted for or improperly safeguarded,
- instances where it is observed that accounting and other information systems, including systems relating to economy and efficiency, are absent, inadequate or not being complied with,
- situations where it is observed that accounting policies and reporting practices are inappropriate or inadequate, and
- other matters considered by the Auditor General to be appropriate to report.

4.3.2 Section 18 of the Act requires all financial statements to be audited every year. The work necessary to report on these statements in accordance with generally accepted auditing standards is considerable and consumes a large portion of the Audit Office's resources each year.

Sections 19 and 28 of the Act require the Auditor General to report systems deficiencies, legislative non-compliance or inadequately safeguarded public assets, if they are observed and if the Auditor General considers them to be significant. These sections of the Act do not require the Audit Office to examine each year every area, circumstance or system that could reveal problems of this nature.

4.3.3 An audit in accordance with generally accepted auditing standards is designed primarily to attest to the fair presentation of financial statements. It is not designed to find the various irregularities reportable under section 19 and 28, though in practice some may come to the auditor's attention as a by- product of the work performed. The Auditor General believes, however, that a legislative expectation exists for the work of his Office to extend beyond seeking matters reportable under sections 19 and 28 only as a by-product of adhering to the minimum requirements of generally accepted auditing standards. For this reason, annual audits are generally approached with three main objectives. In addition to the work designed to attest to the fair presentation of financial statements (the financial audit) the following work is undertaken:

- At the beginning of each audit, significant financial and administrative authorities that impact the entity's operations are identified. During the audit, all transactions examined as part of the financial audit are also examined to determine whether or not they comply with the identified authorities. Any observed instances of non-compliance with prevailing authorities can be reported to management and, where appropriate, to the Legislative Assembly.

- All significant accounting systems are subjected to preliminary evaluation procedures. This invclves documenting the systems and reviewing their design and objectives to identify apparent strengths and weaknesses. Where the auditor wishes to rely on the key controls thus identified for attest purposes, they are compliance tested to determine whether or not

they are working effectively. Where, however, the effective operation of these controls is not relied upon to support the audit opinion on the financial statements, the controls may be compliance tested every few years on a rotational basis. In addition, many less significant financial control systems are also subjected to preliminary evaluation procedures on a rotational basis.

— Other information systems are audited on a selective basis. The main purpose of auditing information systems is to help management improve the systems it has to ensure that the objectives of the enterprise are achieved. This, however, should not be interpreted as auditing Government decisions and policies; these are correctly beyond the scope of a legislative auditor's mandate.

The scope of the Audit Office's activity as described above relating to systems exceeds the minimum requirements of generally accepted auditing standards. The approach, however, enables the Auditor General to report more extensively to management and, where appropriate, to the Legislative Assembly, as he believes is expected of him.

4.3.4 The Audit Office has developed several unique auditing methodologies and techniques to facilitate the conduct of audit work. This was necessary in view of the extended systems auditing strategies outlined above which often present unique auditing challenges particularly where, as is usually the case, the audit entity makes extensive use of computers and complex data processing systems to maintain records and monitor the delivery of services and programs.

4.3.5 An audit support software package developed by the Audit Office is called PROBE — a generalized file interrogation system. PROBE facilitates the auditor's examination and review of data files and systems. The immediate objectives of PROBE, established prior to development, were that the system should permit the following:

— A way to process files from any computer system encountered.
— Processing of multiple file and record types within an audit procedure.
— Interactive processing for identifying and correcting problems quickly.
— A processing environment that would allow central storage of audit procedures.
— On-line help and training that would keep classroom introductory seminars to two days or less.
— Optimum processing efficiency, to reduce the processing costs associated with the large files commonly encountered in government, and to speed up the audit process.

An article entitled "Processing with Probe: A Productive Tool for Auditors" was published in the August 1986 issue of CA Magazine.

4.3.6 Many of the techniques adopted by the Audit Office emphasize the prevention of errors and irregularities, rather than attempting to be purely detective. The Auditor General believes that diagnosing and eliminating weaknesses in accounting and other information systems will minimize the potential for loss and waste of public monies and resources.

4.3.7 Before leaving the subject of audit approaches, and to avoid possible misunderstandings, it may be appropriate to elaborate on the application of generally accepted auditing standards to the detection of fraud and error.

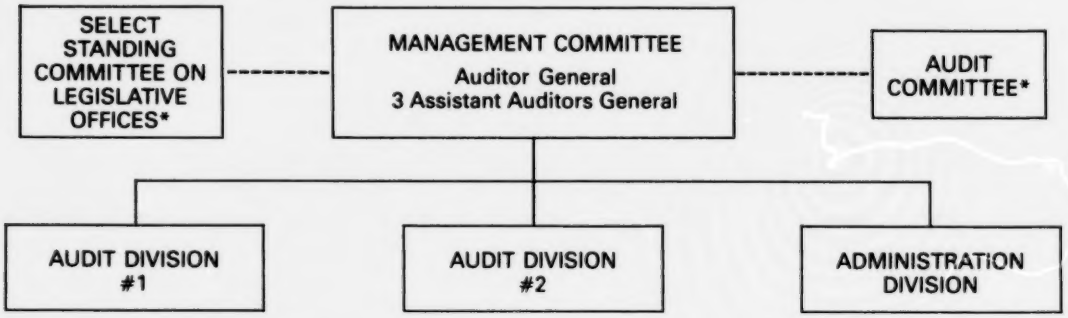
In an examination made in accordance with generally accepted auditing standards, an auditor fulfills his professional responsibility by complying with those standards. When conducting an audit in accordance with generally accepted auditing standards, an auditor seeks reasonable assurance that fraud and error, which may be material to the financial statements or other

accountability information, have not occurred or that, if they have occurred, they are corrected and appropriately reported. When planning his examination, the auditor is responsible, within the inherent limitations of the auditing process, for considering the risk of fraud and error and being alert for circumstances that might cause him to suspect their existence. If at any time his suspicions are aroused, the auditor must perform additional procedures to confirm or dispel those suspicions. Beyond that, the auditor has no separate or additional responsibility for detecting fraud and error.

It must be realized, therefore, that an audit performed in accordance with generally accepted auditing standards may not detect, and is not primarily designed to detect, every instance of fraud or error. The inherent limitations in the audit process are virtually unavoidable. An auditor would not have the resources to examine the circumstances behind and the support for every transaction recorded. Even if he had, he could not be sure that there were no unrecorded transactions. Furthermore, collusion between auditee personnel and outside parties, or among management or employees could result in apparently genuine but falsified transactions and documents being accepted by the auditor.

4.4 ORGANIZATION OF THE AUDIT OFFICE

4.4.1 On April 1, 1986 the Audit Office made certain organizational and operational changes for the purpose of improving the management and operations of the Office and thereby improving internal accountability. The revised organization structure is as follows:



*see section 4.2.7 of this report.

The Management Committee

4.4.2 The Audit Office is administered by the Management Committee. The Committee sets, and monitors the achievement of, the policies designed to discharge the Auditor General's legislatively prescribed responsibilities.

The Audit Divisions

4.4.3 Each of the two Audit Divisions is jointly administered by an Assistant Auditor General and an Executive Director; the Assistant Auditor General is responsible to the Management Committee for his Division. The Assistant Auditor General and Executive Director within an Audit Division each control a number of the audits assigned to their Division. The planning and execution of audits is the direct responsibility of the Audit Principals within each Division. Audit Principals fulfill their responsibilities with the assistance of the Audit Managers, EDP Audit Managers and Supervisors assigned to each Audit Division. Each Audit Division has its own Staff Group comprising student auditors pursuing a professional accounting designation. The deployment of resources in two audit divisions is designed for economy and efficiency.

The Administration Division

4.4.4 The Administration Division is jointly administered by an Assistant Auditor General and an Executive Director; the Assistant Auditor General is responsible to the Management Committee for the Division. The Division provides a variety of administrative services to the Audit Office. The most important function of the Division is monitoring the implementation of policies and directives issued from time to time by the Management Committee.

The Division is responsible for the selection and hiring of staff, personnel, the time recording system and co-ordinating budgetary and accounting functions. It exercises quality control over all audit reports, financial statements, management letters and other output of the Audit Office. This includes monitoring for adherence with established policies and standards and maintaining the Audit Office Staff Manual.

The professional practices and professional development functions are also performed by the Administration Division. These include establishing practice standards and policies, administering the Office's internal practice review program, maintaining the Office library, and developing and presenting courses on audit related subjects.

The Administration Division is also responsible for producing the Auditor General's Annual Reports to the Legislative Assembly.

4.4.5 The Audit Office has continued the policy of utilizing the services of firms of private sector chartered accountants. These firms act as agents of the Auditor General under section 10 of the Auditor General Act. The contributions of agents in supplementing the staff resources of the Audit Office are gratefully acknowledged. Agents acting in respect of the fiscal year ended March 31, 1986 were as follows:

Arthur Andersen & Co.
Bailey Foulkes-Jones Lundell
Bevan, Halbert & Ginet
Carpenter & Company
Clarkson Gordon
Collins Barrow
Coopers & Lybrand
Cuthbertson Stainthorpe Sandall
Deloitte Haskins & Sells
Ernst & Whinney
Hudson & Company
Johnston, Morrison, Hunter & Co.
MacKay & Partners
Matthew Craig Watts Davies
Mills Macleod Unrau
Pannell Kerr Forster
Peat, Marwick, Mitchell & Co.
Price Waterhouse
Thorne Riddell
Touche Ross & Co.
Young, Parkyn, McNab & Co.
Watkinson, Hanhart, Duda, Dorchak
Vennard Johannesen & Co.

4.4.6 The audited financial statements of the Office of the Auditor General are reproduced on page 28.19 of Volume II of the public accounts 1985-86 in accordance with section 30(4) of the Auditor General Act.

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Water Resources Revolving Fund	3.12	2.12.2
Provincial Corporations:		
Alberta Environmental Research Trust	5.83	2.12.2
Alberta Special Waste Management Corporation	5.86	2.12.2
Environment Council of Alberta	5.89	2.12.2
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The Wild Rose Foundation	5.98	2.13.1
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The Workers' Compensation Board	7.16	2.13.2
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Department of Forestry	2.3	2.15.1
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Forest Development Research Trust Fund	4.15	2.15.3
Homestead Lease Loan Fund	4.3	2.15.3
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Junior Forest Ranger Program Fund	8.63	2.15.3
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University Hospitals Foundation		2.16.12
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Provincial Corporations:		
Alberta Mortgage and Housing Corporation	5.105	2.17.2
LABOUR:		
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Metis Settlement Associations Grants Administration Fund	8.63	2.20.3
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The Recreation, Parks and Wildlife Foundation	5.125	3.2.2	2.22.3
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Alberta Alcohol and Drug Abuse Commission	5.129		2.23.2
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Child Welfare Trust	8.63		2.23.2
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Alberta Racing Commission	5.133		2.24.2
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Correctional Institutions Trust Accounts	8.63		2.24.2
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The Alberta Educational Communications Corporation	5.138		2.25.3
Alberta Research Council	5.144	3.2.5	2.25.1
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The Alberta Government Telephones Commission	7.32		2.25.2
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Alberta Heritage Savings Trust Fund	4.33		2.28.3
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Provincial Corporations:		
Alberta Electric Energy Marketing Agency	5.163	2.29.2

B. Entities audited pursuant to section 12(b) of the Auditor General Act

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ACCESS Charitable Foundation		2.30.2
Alberta Children's Hospital Research Centre		2.30.2
Banff Television Foundation	3.2.2	2.30.2
Centre for Frontier Engineering Research Institute		2.4.10
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Foothills Hospital Employees' Charity Fund		2.30.2
Foothills Hospital Foundation	3.2.2	2.30.2
Glenrose Rehabilitation Hospital Employee Benevolent Fund		2.30.2
Glenrose Rehabilitation Hospital Employee Charities Fund		2.30.2
Grande Prairie Regional College Foundation	3.2.2	2.30.2
Olds College Foundation	3.2.2	2.30.2
Sulphur Development Institute of Canada (SUDIC)	3.2.7	2.30.2
Technical Resource Centre Society for Technology and Rehabilitation	3.2.2	2.30.2
The University of Alberta Foundation*		2.4.10
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The Trustees of the Academic Staff Benefits Plans of the University of Alberta		2.4.10
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University of Alberta Hospitals Employees' Benevolent Fund		2.30.2
University of Alberta Hospitals Employees' Charities Trust		2.30.2

*Crown-controlled organization

C. Entities reviewed pursuant to section 16 of the Auditor General Act

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D. Entities audited pursuant to section 43 of the Irrigation Act

	References to Observations in this report
Aetna Irrigation District	2.30.1
Bow River Irrigation District	2.30.1
Eastern Irrigation District	2.30.1
Leavitt Irrigation District	2.30.1
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Macleod Irrigation District	2.30.1
Magrath Irrigation District	2.30.1
Mountain View Irrigation District	2.30.1
Raymond Irrigation District	2.30.1
Ross Creek Irrigation District	2.30.1
St. Mary River Irrigation District	2.30.1
Taber Irrigation District	2.30.1
United Irrigation District	2.30.1
Western Irrigation District	2.30.1